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OCTOBER 18TH–24TH 2008

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CAPITALISM AT BAY

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Politics this week

Oct 16th 2008
From The Economist print edition

Amid anxiety about recessionary pressures in the world economy, which caused stockmarkets to tumble once again, the United States Treasury reported that America's **budget deficit** stood at a record $455 billion for the year ending September 30th. The deficit is expected to swell even higher next year once the short-term costs of the government's bail-out of the banking system are factored in. The nation's debt clock in New York has been given an extra digit, since the sum has topped $10,000,000,000,000. See article

Despite the worsening fiscal environment, the presidential candidates unveiled additional proposals to **boost America's economy**. Barack Obama said he would work with Congress immediately after the November 4th election to pass an additional $60 billion in tax breaks and other stimulus measures; John McCain proposed an extra $53 billion in tax breaks to provide relief to the elderly and unemployed. See article

AP

At the final **presidential debate**, Mr McCain did well and energised the proceedings by hammering his opponent on a range of issues. However, Mr Obama kept his cool and came out on top; he retains a sizeable lead in the polls. See article

A bipartisan report found that **Sarah Palin**, Mr McCain's running-mate, had "abused her power" as governor of Alaska by waging a campaign to sack a state trooper (he was the ex-husband of Mrs Palin's sister and had allegedly threatened violence). The report now goes to the legislature.

California's bond sale got off to a good start. The state is offering an initial $4.5 billion to investors to help it secure short-term loans until next spring, when it reaps a tax bonanza. The financial crisis has made it difficult for states to fund their budget requirements. California's governor, Arnold Schwarzenegger, has said that if his state does not get the loans it may need to seek federal assistance.

A sharper Harper

Getty Images

In **Canada's** general election, Stephen Harper, the prime minister, failed to win the parliamentary majority he sought for his Conservative Party, but picked up an extra 19 seats in the House of Commons. The opposition Liberals fared poorly, losing 19 seats; the leftist New Democrats gained eight seats; the separatist Bloc Québécois prevented the Conservatives from picking up seats in Quebec. Mr Harper will now lead a stronger minority government. See article

Peru's president, Alan García, appointed a new cabinet headed by Yehude Simon, a moderate left-winger. The previous cabinet resigned over a corruption scandal involving oil-exploration contracts. See article

Thirteen **Caribbean** countries signed an Economic Partnership Agreement with the European Union, replacing the previous Cotonou Agreement that offered trade preferences to former European colonies. See article

Nifty Nicolas

At yet another in a string of **European Union** summits under France's hyperactive president, Nicolas Sarkozy, Europe's leaders congratulated themselves on their bail-out of the banks and agreed that new global regulation was needed. But they promptly fell out over climate-change targets. See article

Talks in Geneva between **Georgia, Russia** and representatives of the disputed enclaves of Abkhazia and South Ossetia broke down amid a big row.

As expected, Ilham Aliev was overwhelmingly re-elected as president of **Azerbaijan**. Most leading opposition candidates boycotted the poll because it was neither free nor fair.

The two main **Austrian** political parties moved closer to forming a grand coalition after the death in a car crash of Jörg Haider, leader of one of two far-right parties that had done well in the recent election. See article

Crossed off

America removed **North Korea** from its list of state sponsors of terrorism. North Korea allowed UN nuclear inspectors back into its Yongbyon nuclear facility. See article

China's Central Committee announced "a new upsurge" in land reform, raising hopes that changes might be made to the ownership of rural land, which is still collective. But the details of any new policy have not been made public. See article

China ordered the withdrawal of all milk and **milk products** made before September 14th. Four children died and thousands became ill after the milk had been tainted, apparently to give it the appearance of a higher protein content.

Thailand's **Queen Sirikit** attended the cremation ceremony of an anti-government protester who died after clashes with the police. This led the People's Alliance for Democracy, which is trying to bring down the government, to claim that it has royal support for its protests. See article

New border clashes erupted between **Thailand** and **Cambodia** around the site of a disputed temple. The Cambodian government said two of its soldiers had been killed.

Sounding out the ministries

A month after Robert Mugabe and Morgan Tsvangirai agreed to share power in **Zimbabwe**, Thabo Mbeki, the recently ousted South African president who brokered the deal, returned to the fray in an effort to break a stalemate over the allocation of government ministries. See article

Mbhazima Shilowa, a former premier of **South Africa's** richest province, Gauteng, resigned from the ruling African National Congress to join other rebels led by a former defence minister, Mosiuoa Lekota. They may found a new party after a split between supporters of Mr Mbeki and those of Jacob Zuma, the country's probable next president.

AFP

Fighting intensified in north-east **Congo** between forces of the national army and rebels loyal to a Tutsi general, Laurent Nkunda, whom the Congolese accuse of getting help from neighbouring Tutsi-led **Rwanda**, which denies the charge. Relations between the two countries worsened. United Nations peacekeepers seemed unable to hold the ring. See article

Thousands of **Iraqi** Christians in the turbulent northern city of Mosul fled their homes, fearing for their lives after a dozen had been killed, apparently by extreme Sunni Islamists. The government in Baghdad said it had sent more than 1,000 extra police to protect the religious minority. About one-third of the country's 800,000-odd Christians have fled since the American-led invasion in 2003.

Business this week

Oct 16th 2008
From The Economist print edition

Governments around the world took extraordinary steps to shore up their banking systems. Britain led the way, unveiling a plan partially to nationalise some of its biggest banks: £20 billion ($35 billion) of public money will be injected into **Royal Bank of Scotland** and £17 billion into **HBOS** and **LloydsTSB** (which have announced a merger) in return for substantial stakes—around 60% in RBS and 40% in Lloyds TSB-HBOS. See article

America followed suit by providing $250 billion for bank recapitalisation; half will go to nine banks, including **Bank of America**, **JPMorgan Chase**, **Citigroup**, **Goldman Sachs** and **Morgan Stanley**. In return the government gets non-voting preference shares that pay a 5% dividend, rising to 9% after five years. Hank Paulson, the treasury secretary, acknowledged that most Americans found it "objectionable" that the government had to take stakes in the banks, but said the alternative of "leaving businesses and consumers without access to financing is totally unacceptable". See article

In a sign that tensions exist between policymakers crafting these plans, **Sheila Bair**, head of the Federal Deposit Insurance Corporation, criticised America's $700 billion rescue package for banks for not doing more to help homeowners avoid foreclosure.

Governments in the **euro zone** also took action. Germany said it would guarantee bank debt to the tune of €400 billion ($540 billion) and supply an extra €100 billion to stabilise financial markets; France unveiled a €360 billion package of measures, including €40 billion of capital funding for banks; and the Netherlands guaranteed €200 billion in interbank lending. Austria, Italy, Spain and others also produced proposals. See article

UBS also got a bail-out. The Swiss government took a 9% stake in the bank and created a fund that allows UBS to offload $60 billion in toxic assets.

The board of the **Bank of Japan** held an emergency meeting and decided to loosen up companies' access to cash. **Hong Kong** provided a blanket guarantee on all bank deposits. And **Australia's** prime minister introduced a stimulus bill to boost the economy, including funding for first-time homebuyers.

The **United Arab Emirates** pledged an extra $19 billion for its banks. **Qatar** said it would take stakes of up to 20% in banks so that they could continue to fund regional infrastructure projects. Some questioned whether the Gulf states' sovereign-wealth funds still had an appetite to invest abroad, a lifeline to many earlier in the credit crunch.

Morgan Stanley finalised a deal in which it will sell a 21% stake for $9 billion to Japan's **Mitsubishi UFJ**. Concerns that the transaction would be held up had caused Morgan Stanley's share price to dive.

Federal regulators expedited their approval of **Wells Fargo's** acquisition of **Wachovia**. The deal is not dependent on public money, unlike the agreement that **Citigroup** thought it had obtained in September to take over Wachovia, only to be told that the preferred suitor was Wells Fargo. Citi vowed to pursue "vigorously" its legal claims against the pair for billions of dollars.

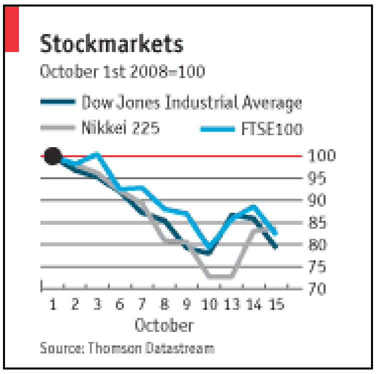
India's finance minister reassured investors that **ICICI** was safe. The country's second-largest lender was hit by another rush of withdrawals amid rumours that it was insolvent. The bank has asked police to investigate what it alleges is an attempt to smear its name and cause a run.

With trust eroding in the state of the **Russian banking** system, Globex stopped customers from withdrawing their funds after a run on the bank. See article

There were more indications that the financial crisis and recessionary fears were affecting technology companies. India's **Infosys** slashed its earnings forecast for the year (it derives a large chunk of its business from data services to America's financial companies). **Philips Electronics** said demand had dropped. And **Samsung Electronics** reduced its output of flat-panel screens. **Intel** reported that business remained buoyant, but that it would issue an update in the fourth quarter.

The **Hapag-Lloyd** shipping line was sold to a consortium for €4.5 billion ($6 billion). The deal came despite a downturn in **shipping**, in part caused by banks' hesitation to issue the letters of credit that assure transactions between sellers and buyers of cargo.

Following one of the worst ever weeks for **stockmarkets**, indices rebounded on news of the government rescue deals. However, investors soon abandoned their optimism for fears of a global recession. On October 15th the Dow Jones Industrial Average fell by 733 points, or 7.9%, its largest percentage decline since 1987.



Economist.com OPINION

KAL's cartoon

Oct 16th 2008
From The Economist print edition

Illustration by KAL

Economist.com OPINION LEADERS

The world economy

Capitalism at bay

Oct 16th 2008
From The Economist print edition

What went wrong and, rather more importantly for the future, what did not

ONE hundred and sixty five years ago, a Scottish businessman set out his plans for a newspaper. James Wilson's starting point was "a melancholy reflection": "while wealth and capital have been rapidly increasing" and science and art "working the most surprising miracles", all classes of people were marked "by characters of uncertainty and insecurity". Wilson's solution was freedom. He committed his venture to the struggle not just against the protectionist corn laws but against attempts to raise up "barriers to intercourse, jealousies, animosities and heartburnings between individuals and classes in this country, and again between this country and all others". Ever since, *The Economist* has been on the side of economic liberty.

Now economic liberty is under attack and capitalism, the system which embodies it, is at bay. This week Britain, the birthplace of modern privatisation, nationalised much of its banking industry; meanwhile, amid talk of the end of the Thatcher-Reagan era, the American government has promised to put $250 billion into its banks. Other governments are re-regulating their financial systems. Asians point out that the West appears to be moving towards their more *dirigiste* model: "The teachers have some problems," a Chinese leader recently said. Interventionists are in full cry: "Self-regulation is finished," claims France's Nicolas Sarkozy. "Laissez-faire is finished." Not all criticisms are that unsubtle (the more pointed ones focus on increasing the state's role only in finance), but all the signs are pointing in the same direction: a larger role for the state, and a smaller and more constrained private sector.

This newspaper hopes profoundly that this will not happen. Over the past century and a half capitalism has proved its worth for billions of people. The parts of the world where it has flourished have prospered; the parts where it has shrivelled have suffered. Capitalism has always engendered crises, and always will. The world should use the latest one, devastating though it is, to learn how to manage it better.

Extreme measures in the defence of liberty

In the short term defending capitalism means, paradoxically, state intervention. There is a justifiable sense of outrage among voters and business people (and indeed economic liberals) that $2.5 trillion of taxpayers' money now has to be spent on a highly rewarded industry. But the global bail-out is pragmatic, not ideological. When François Mitterrand nationalised France's banks in 1981 he did so because he thought the state would run them better. This time governments are buying banks (or shares in them) because they believe, rightly, that public capital is needed to keep credit flowing.

Intervening to prevent banking crises from hurting the real economy has a strong pedigree. Wilson's son-in-law, Walter Bagehot, recommended that the Bank of England lend generously (but at a penalty rate) to illiquid banks (but not to insolvent ones). In modern times governments of every political stripe have had to step in. Ronald Reagan and Margaret Thatcher oversaw the rescues of Continental Illinois and Johnson Matthey. In the 1990s the Finns and Swedes nationalised banks—and privatised them again later. This rescue is on a different scale. Yet the justification is the same: the costs of not intervening look larger. If confidence and credit continue to dry up, a near-certain recession will become a depression, a calamity for everybody.

Even if it staves off disaster, the bail-out will cause huge problems. It creates moral hazard: such a visible safety net encourages risky behaviour. It may also politicise lending.

Governments will need to minimise these risks. They should avoid rewarding the bosses and shareholders of the rescued banks. They must not steer loans to politically important sectors. And they should run the banks on a commercial basis with the explicit aim of getting out of the banking business as quickly as possible (and at a profit). From the taxpayer's point of view, it might make sense to limit dividend payments to other shareholders until the government's preference shares have been paid off. But governments need to avoid populist gestures. Banning bonuses, for instance, would drive good people out of companies that badly need them.

The politicians all claim they understand this. Of course, they have no intention of revisiting Mitterrand's mistakes, of trying to run the banks themselves, or of taking stakes elsewhere. Yet already voices (including Lady Thatcher's Tory heirs) are pushing to limit executive pay. It will be a brave president who goes to Detroit and explains why the 45,000 well-paid folk at Morgan Stanley should get $10 billion of taxpayers' money, but the 266,000 people at General Motors should not. Brave too would be any politician who proposed deregulation as a solution to a public-sector problem.

Smoot-Hawley in the rear mirror

Given this, it is inevitable that the line between governments and markets will in the short term move towards the former. The public sector and its debt will take up a bigger portion of the economy in many countries. But in the longer term a lot depends on how blame for this catastrophe is allocated. This is where an important intellectual battle could and should be won. Capitalism's defenders need to deal with two sorts of criticism. One has much more substance than the other.

The weaker, populist argument is that Anglo-Saxon capitalism has failed. Critics claim that the "Washington consensus" of deregulation and privatisation, preached condescendingly by America and Britain to benighted governments around the world, has actually brought the world economy to the brink of disaster. If this notion continues to gain ground, politicians from Beijing to Berlin will feel justified in resisting moves to free up the movement of goods and services within and between their economies. Arguments for market solutions in, for instance, health and education will be made with less conviction, and dismissed with a reference to Wall Street's fate.

In fact, far from failing, the overall lowering of "barriers to intercourse" over the past 25 years has delivered wealth and freedom on a dramatic scale. Hundreds of millions of people have been dragged out of absolute poverty. Even allowing for the credit crunch, this decade may well see the fastest growth in global income per person in history. The free movement of non-financial goods and services should not be dragged into the argument—as they were, to disastrous effect, in the 1930s.

A second group of critics focuses on deregulation in finance, rather than the economy as a whole. This case has much more merit. Finance needs regulation. It has always been prone to panics, crashes and bubbles (in Victorian times this newspaper was moaning about railway stocks, not house prices). Because the rest of the economy cannot work without it, governments have always been heavily involved.

Without doubt, modern finance has been found seriously wanting. Some banks seemed to assume that markets would be constantly liquid. Risky behaviour garnered huge rewards; caution was punished. Even the best bankers took crazy risks. For instance, by the end of last year Goldman Sachs, by no means the most daring, had $1 trillion of assets teetering atop $43 billion of equity. Lack of regulation encouraged this gambling (see article). Financial innovation in derivatives soared ahead of the rule-setters. Somehow the world ended up with $62 trillion-worth of credit-default swaps (CDSs), none of them traded on exchanges. Not even the most liberal libertarian could imagine that was sensible.

Yet the failures of modern finance cannot be blamed on deregulation alone. After all, the American mortgage market is one of the most regulated parts of finance anywhere: dominated by two government sponsored agencies, Fannie Mae and Freddie Mac, and guided by congressional schemes to increase home-ownership. The macro economic condition that set up the crisis stemmed in part from policy choices: the Federal Reserve ignored the housing bubble and kept short-term interest rates too low for too long. The emerging world's determination to accumulate reserves, especially China's decision to hold down its exchange rate, sent a wash of capital into America. There was something of a perfect storm in which policy mistakes combined with Wall Street's excesses.

Heavy regulation would not inoculate the world against future crises. Two of the worst in recent times, in Japan and South Korea, occurred in highly rule-bound systems. What's needed is not more government but better government. In some areas, that means more rules. Capital requirements need to be revamped so that banks accumulate more reserves during the good times. More often it simply means different rules: central banks need to take asset prices more into account in their decisions. But there are plenty of examples where regulation could be counter-productive: a permanent ban on short-selling, for instance, would make markets more volatile.

Indeed, history suggests that a prejudice against more rules is a good idea. Too often they have unintended consequences, helping to create the next disaster. And capitalism, eventually, corrects itself. After a crisis investors (and for that matter regulators) seldom make exactly the same mistake twice. There are, for instance, already plans for clearing houses for CDSs.

Turning back the incoming tide

Sadly another lesson of history is that in politics economic reason does not always prevail—especially when the best-case scenario for most countries is a short recession. "Barriers to intercourse, jealousies, animosities and heartburnings" loom.

But it need not be so. If the bail-outs are well handled, taxpayers could end up profiting from their reluctant investment in the banks. If regulators learn from this crisis, they could manage finance better in the future. If the worst is avoided, the healthy popular hostility to a strong state that normally pervades democracies should reassert itself. Capitalism is at bay, but those who believe in it must fight for it. For all its flaws, it is the best economic system man has invented yet.

Economist.com OPINION LEADERS

Russia and Europe

Too soon to kiss and make up

Oct 16th 2008
From The Economist print edition

The European Union should not give Russia a new partnership deal until it genuinely withdraws from Georgia

Get article background

RUSSIA announced this week that, just as it promised, it had pulled all its troops in Georgia back to the two disputed territories of Abkhazia and South Ossetia. Many European Union leaders were swift to praise the Kremlin for meeting the conditions it agreed with France's Nicolas Sarkozy some six weeks ago—and almost as quick to suggest a return to business as usual. A majority now want to start talks in November on a new "partnership and co-operation agreement". Their none-so-subtle message is: forget about the pesky Georgian president, Mikheil Saakashvili, who was anyway responsible for starting the war on August 7th, and attend instead to the more urgent task of repairing relations with our biggest energy supplier.

The West needs to keep talking to Russia about many things, notably efforts to prevent Iran from acquiring nuclear weapons and further reductions in Russia's and America's own nuclear arsenals. Yet it would be wrong to heed calls from the likes of Germany, Italy and their allies to start talks now on a new partnership agreement, as if the Georgian war had never happened. The main reason for this is that the troop withdrawal is largely bogus. The Russians have stationed almost 8,000 troops in the two enclaves. Villages in South Ossetia and beyond have been brutally cleansed of their Georgian inhabitants. And Abkhaz forces have retaken the Kodori Gorge, previously controlled by the Georgians. This does not come close to a pull-back to pre-August 7th positions, which is what the EU originally stipulated before embarking on a new partnership agreement. Moreover, the Russians still refuse to allow any of the 200-odd ceasefire monitors deployed by the EU into the two disputed territories.

Some regard Georgia and the Caucasus as small, faraway and so unimportant. They are, on the contrary, a strategically vital region that could play a critical role in the EU's future energy security (see article). And, as Mr Saakashvili has often said, if the Russians think they can escape unpunished for the invasion and occupation of parts of his country, that could embolden further adventurism. The war was popular with ordinary Russians: the popularity of President Dmitry Medvedev and the prime minister, Vladimir Putin, has risen even as financial markets have tanked. There are plenty of Russian citizens and passport-holders in such neighbours as Ukraine, Belarus and the Baltics whom the Kremlin might easily find a sudden need to "protect", just as it did in South Ossetia.

Besides, this is not just about the Caucasus. Both Mr Medvedev and his foreign minister, Sergei Lavrov, have muttered belligerent things about Russia's neighbours and the West in general. Its short war with Georgia seems to have confirmed Russia's prejudice that it can cow its neighbours—including some members of the EU—by threatening or even using force. The Russians continue to treat the supply of energy as another weapon in their armoury. There can be no genuine partnership with the EU while

Russia thinks this way.

Neighbourhood watch

The EU should be urgently seeking to put more substance into the neighbourhood policy that defines its dealings with Russia's near-abroad. For all his annoying arrogance, Mr Saakashvili is a democratically elected president who has liberalised Georgia's economy and cracked down on corruption. Ukraine's democracy may sometimes resemble a tragicomedy (it is currently preparing for its third parliamentary election in the space of three years), but it is vigorous for all that. Even the autocratic Armenia and Azerbaijan may now look more to the West than they did before the war in Georgia. Belarus, widely known as Europe's last dictatorship, is shifting its ground a little—as the EU recognised this week when it decided to relax its visa ban on the country's leaders.

The EU could help these countries by offering financial aid, more open trade deals and easier visa conditions. It should also hold out to them prospect of eventual membership. This is less provocative than the notion of letting any of them into NATO, which has surely receded into the future after the Georgian war. But as experience in the Balkans has shown, the lure of eventual EU membership is a good way to foster liberal, market-based democracy and to defuse territorial and ethnic disputes. As for Russia, its help is still needed on some vital global issues. But for the EU to go ahead with new "partnership" talks now would send a message of astounding pusillanimity. At the very least, Russia needs first to live up to its promises to withdraw properly from Georgia and to let the EU's monitors into the disputed enclaves.

Afghanistan

No time to go wobbly

Oct 16th 2008
From The Economist print edition

Talking to some of the Taliban makes sense. But there is no short cut to peace

IT DOES not take the leak of an American intelligence assessment to know that Afghanistan is, as the spooks put it, "on a downward spiral". That was all too apparent in April, when a military parade attended by President Hamid Karzai came under fire in view of television cameras.

The vortex started in 2006, when NATO troops were deployed in southern Afghanistan and stumbled into a full-blown insurgency. Since then each year has been bloodier; every spring NATO commanders plan an offensive to stop the Taliban's spring offensive, and every autumn they count more bodies and cry out for reinforcements. This year, says the United Nations, there may not be a winter lull. Thousands of Afghan civilians are being killed, by both sides. More of the country is being marked as "hostile" to aid workers (see map). Provinces around Kabul are becoming ever more dangerous.

With its superior firepower, NATO can win any battle, but it is losing the war—or at least not winning, which may amount to the same thing. It is alarming, therefore, that the British seem to be losing heart in Afghanistan just as America is rethinking its strategy and sending more forces (see article). The British ambassador to Kabul is said in a leaked report to have concluded that America's strategy was doomed to fail, and that foreign forces were part of the problem, not the solution.

As Margaret Thatcher once put it, this is no time to go wobbly. The past two years in Iraq show that a seemingly hopeless situation can be turned around. Many Afghans remember the misery of Taliban rule and support the presence of foreign troops. More American forces are being released from Iraq, and the new government in Pakistan seems more serious about taking control of the militant havens in its tribal belt.

That said, Afghanistan will remain poor and unstable for a long time. America should not think it can easily orchestrate a comprehensive Iraq-style tribal uprising against the insurgents, as some hope. In contrast to the foreign fighters in Iraq, the Taliban are mainly locals. But the other quick fix being proposed by the wobblers—negotiating a settlement with the Taliban—is not realistic either. There is no sign that the Taliban leadership is interested in a deal. President Karzai has already held out an olive branch, sending his brother to talk to figures close to the Taliban in Saudi Arabia. But their response has been more bombs and mockery. The Taliban say there is nothing to talk about until foreign troops leave; and they see the rumours of talks as a sign that they are on the verge of victory.

The right kind of dialogue

Like economic development, political reconciliation does indeed need to be part of the solution for

Afghanistan. But some differences go too deep to be negotiated away. If the Taliban want to wind the clock back to where it was before the American invasion, when they harboured al-Qaeda and ruthlessly oppressed their own people, there can be no agreement with them. A more realistic strategy is to isolate the hardliners by cutting deals with individual insurgent commanders, and wooing disaffected tribal groups over to the government side. But that will not happen on a significant scale without two things: greater security, to keep the support of the population and protect those who throw in their lot with the government; and a government that looks credible, legitimate and effective enough to offer a more attractive alternative to the Taliban.

In the short term, improving security will require a surge of Western forces to stop the country from spinning out of control. In the longer run Afghans will progressively have to take over the fighting. To do so, the Afghan army, a decent force belatedly being expanded from 88,000 to more than 122,000 men, will need at least to be doubled in size. The police badly need reforming. European allies unwilling or unable to send more fighting troops should help pay for this. Strengthening the security forces will be expensive, but cheaper than trying to garrison Afghanistan permanently with Western troops.

At the same time, the West needs to get serious about the enemy within: the chronic corruption and ineffectiveness of Mr Karzai's administration, whose many failures are pushing disappointed Afghans into the hands of the insurgency. For too long the Americans have regarded Mr Karzai as indispensable. George Bush placed too few demands on him. If Mr Karzai's recent cabinet reshuffle heralds more resolute action, he could yet redeem himself. But he faces re-election in 2009. America's new president should make it clear that Western support for Afghanistan will continue, but that support for Mr Karzai will no longer be unconditional.

Zimbabwe

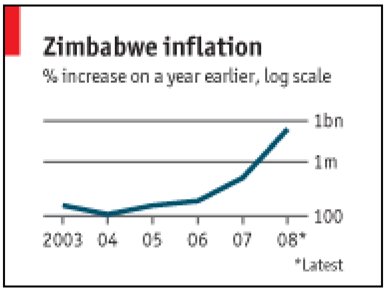
A need to knock heads together

Oct 16th 2008
From The Economist print edition

South Africa's new leaders must step into the ring

Get article background

MORE than a month after Robert Mugabe agreed to share power with Morgan Tsvangirai, the pair have yet to start governing together to rescue Zimbabwe from its rapidly deepening misery. As *The Economist* went to press, there were hopes once more of a breakthrough in the negotiations. But Thabo Mbeki, who oversaw the original agreement, is no longer South Africa's president and has lost the heft he needs to persuade Mr Mugabe to implement it. In any event Mr Mbeki should step down as mediator and give way to Jacob Zuma, South Africa's probable next president. And if Mr Zuma is unable or unwilling to take on the job, the UN's former secretary-general, Kofi Annan, a proven negotiator, should be asked in to break the stalemate.



Mr Mugabe has been stalling, perhaps in the hope of wriggling out of the deal altogether. Within days of signing it, he flew off with a vast entourage to rant against "imperialists" at the UN in New York, without the slightest indication that anything had changed back home. Since then, he has breached a plain understanding that the two men (and a small third party) would share out the main ministries in an equitable manner. Most recently, he has unilaterally handed his own party virtually all the portfolios with real clout, including those that run the army, the police, the courts, foreign affairs, the mines, the state-owned media, local government and land resettlement. His spokesman has hinted, presumably as a prelude to offering a concession, that the finance ministry—a poisoned chalice if ever there was one, since inflation is running officially at 231m% and unofficially in the billions—may be open to discussion. The opposition Movement for Democratic Change is rightly refusing to be tricked into playing second fiddle.

You thought it couldn't get worse

Meanwhile, Zimbabwe is dying. It is hard to imagine the misery worsening, yet it is. The currency is worthless. Swathes of public-sector workers are no longer getting paid enough even to buy a few loaves of bread a month; many are not getting paid at all. More than 80% of the people are thought to have no job, beyond subsistence and barter. Some 3m in a population of around 12m have fled abroad. Harrowing reports are filtering out that people are starting to die of starvation. More than 1.4m are suffering from HIV/AIDS. The UN's World Food Programme is trying to keep 2m people alive with food handouts but says that another 3m may need feeding by early next year if mass starvation is to be averted. Mr Mugabe's thugs are still beating and sometimes killing supposed backers of Mr Tsvangirai. The handful of white farmers left on the land is still being harassed. Some of Mr Tsvangirai's closest colleagues still face bogus charges, including treason; the state media peddle packs of lies; foreign reporters cannot visit freely; many foreign charities are unable to operate.

One of the manifold defects of the power-sharing agreement orchestrated by Mr Mbeki last month is that it lacks both a strong arbitrating mechanism and a strong mediator to implement the deal and knock the parties' heads together when things get stuck. The Southern African Development Community (SADC), the 14-country club that has tried to break Zimbabwe's impasse, reappointed Mr Mbeki as chief "facilitator" after the deal was struck, though his stature has shrivelled since he lost the presidency of his own country last month.

Find a new head-banger

That is why it is time for Mr Zuma, head of South Africa's ruling African National Congress (ANC), to displace Mr Mbeki as mediator. Apart from being the coming man in South Africa, he is by nature a more forceful figure. He did a fine job making peace between the ANC and his fellow Zulus after apartheid ended. He would be a lot readier than Mr Mbeki ever was to twist Mr Mugabe's arm. True, the SADC recently renewed Mr Mbeki's mandate, but there is no fixed-term contract; it should quietly press him to step down with good grace.

Mr Zuma may plead that he is too busy trying to heal divisions in the ANC after its own recent internecine battles. In that case the SADC, backed by the African Union, should call on Mr Annan, the experienced Ghanaian who, after running the UN for ten years, managed to cajole Kenya's warring parties into a power-sharing compromise early this year. He has several of the qualities that Mr Mbeki so manifestly lacks, in particular an unwillingness to be pushed around by a clever 84-year-old who refuses to accept that his time is up.

Mr Mugabe, of course, may well seek to reject the good offices of either Mr Zuma or Mr Annan. But as his country descends even deeper into chaos, his ability to pick and choose his mediators is shrinking fast. And Zimbabweans now desperately need a stronger one than Mr Mbeki.

Economist.com OPINION LETTERS

On health care, deposit insurance, drugs, consulting, space, Wall Street

Oct 16th 2008
From The Economist print edition

Medical emergency

SIR – The section on health care in your special briefing on America's election accurately diagnosed the system's two most important problems: soaring costs, which stand at $2.5 trillion, and the lack of insurance coverage for 46m people ("Running for cover", October 4th). Although Barack Obama's health-care plan addresses coverage and John McCain's targets costs, both ignore a critical flaw in the delivery of American health care: an insufficient number of primary-care doctors.

Studies on both sides of the Atlantic have repeatedly demonstrated that primary care provides access, improves outcomes and lowers costs. Yet a national primary-care shortage has been looming for several years in America as doctors retire. One recent study found that just 2% of all the graduates from medical schools in the United States plan to go into primary care, whereas the numbers seeking training in dermatology and radiology are soaring. Neither cost controls nor universal care in America will be possible without an infrastructure that is able to actually deliver primary care and this could take years to tackle.

Dr Patrick Dowling
Professor of family medicine
University of California, Los Angeles
Los Angeles

SIR – Mr Obama and Mr McCain offer prescriptions for reducing the costs of health care. It is a pity that they are treating a symptom and not even talking about the cause: litigation. Health-care costs are ludicrously high in part because doctors have to protect themselves from being sued into bankruptcy for making honest mistakes or for overlooking some obscure test. And for some people the legal costs of challenging the rationale for why they have been denied health-care cover (usually because of some minor error on an application form) can be very high.

You don't fix the health-care system until you fix its accompanying, spectacularly dysfunctional, legal system; a massive, flailing beast that flattens everything it touches.

Michael Ryan
Stockton, California

Insurance plan

SIR – Regarding your article on deposit insurance ("A useful fiction", October 4th), the International Association of Deposit Insurers, which is housed in the Bank for International Settlements in Basel, has given advice on establishing and maintaining limited-coverage deposit-insurance systems since 2002. Blanket guarantees can ultimately be very costly, particularly when banks view such promises as a licence for excessive risk-taking. The costs of protecting deposits should be borne by the banks, not taxpayers.

Governments need help when explaining to the public the benefits and limitations of deposit insurance. Unfortunately, Germany, Ireland, Spain and a number of other European countries chose not to join IADI and participate in the development of guidance. Perhaps recent events will encourage more European banking systems to join IADI and engage in developing unified core principles, effective practices and standards.

John Raymond LaBrosse

Secretary-general 2002-08
International Association of Deposit Insurers
Ottawa

A balanced drugs policy

SIR – The declaration by Mexico's President Felipe Calderón of a "war" on drug gangs and a call from the mayor of Nogales for "heavy-handed" tactics akin to the surge in Iraq against traffickers should be taken with a cautionary grain of salt ("Good neighbours make fences", October 4th). Recall that El Salvador tried a similar approach with its *mano duro* strongman policies only a few years ago; these failed and served as an excuse for a multitude of social sins.

Gang violence is deplorable, and cannot be tolerated, but simply "cracking down" by itself is not the solution. In Los Angeles we have combined tough policing with increased police training and stricter gun control, and have placed more emphasis on keeping youth in school and off the street. We have seen crime drop. Similar policies are working in Brazil.

We hope that Mexico's new "war" succeeds, but we caution against a blowback that only produces another generation of young people hardened into believing that government is a bully and justice is blind.

Bruce Riordan
Director of anti-gang operations for the City of Los Angeles
Los Angeles

Silver linings

SIR – It is unlikely that Wall Street's woes will be "yet another headache for the consulting industry" ("Giving advice in adversity", September 27th). In fact, the inevitable increase in regulation to ease the banking system's problems is bound to provide a rich stream of revenue to consulting firms. The main beneficiaries of any increase in the amount and complexity of regulations are those that are tasked with either helping companies achieve compliance, demonstrate compliance or assure that compliance is a goal. This is typically done by the big four accounting firms through the provision of non-audit services. We only have to look back as far as the post-Enron period and the subsequent Sarbanes-Oxley gravy-train for the evidence.

Tim Jenkins
London

Space technology

SIR – Your briefing on space technology included an interview with Joseph Rouge, director of the National Security Space Office at the Pentagon, about the International Traffic in Arms Regulation ("Earthbound", August 23rd). You stated that Mr Rouge thinks that "Congress and the White House are weighing whether to change the ITAR legislation itself." This statement was taken out of context, and caused some confusion and concern within congressional and Defence Department offices, as there is no current activity to review ITAR legislation. Mr Rouge's comments from the transcript stated that if ITAR legislation were to be reviewed, it would follow the normal congressional process.

Lieut-Colonel Mark Brown
Secretary of the Air Force
Office of Public Affairs
Washington, DC

Looking on the bright side

SIR – Can it really be a coincidence that within weeks of the Large Hadron Collider being switched on for

the first time ("Off into the wild, blue yonder", September 13th) a financial black hole has appeared in the universe?

Barclay Price
Edinburgh

SIR – Readers of your article on the marketing phrases conjured up by banks ("Ad nauseam", October 4th) may recall a 1996 Union Bank of Switzerland advertisement where Ben Kingsley recites "Ozymandias", Percy Shelley's ode to misplaced pride and hubris. Perhaps the ad could be used again for executive and risk-management training.

Edmond Harbour
Sydney

SIR – *The Economist*'s poll of economists managed to find some practitioners of the dismal science who thought that George Bush had sound economic policies ("Examining the candidates", October 4th.) This only goes to prove the adage that there are three kinds of economists: those who can count and those who can't.

Steve Brickle
Biarritz, France

The Caucasus

After the war

Oct 16th 2008 | BAKU, TBILISI AND YEREVAN
From The Economist print edition

An edgy neighbourhood has become both more dangerous and more important

AP

Get article background

THE scenery is breathtaking. Sandwiched between two seas and home to Europe's highest mountains, the Caucasus has always been an alluring and darkly mysterious region. Its reputation rose during its long, slow conquest by imperial Russia in the 19th century. The Caucasus features prominently in the poetry of Pushkin and the fiction of Tolstoy. A classic Russian figure, the "superfluous man" who is powerless and doesn't fit in, first appeared in the character of Pechorin in Lermontov's novel, "A Hero of Our Time", set in the Caucasus. Russian readers were also enthralled by the exploits of the Caucasian resistance hero, Imam Shamil.

Now the Caucasus is at centre-stage again. The restive north Caucasus republics in the Russian federation are always in the news. After two bloody wars with the Russians, Chechnya is more or less at peace under the thumb of its strongman president, Ramzan Kadyrov, but could easily flare up again. Dagestan has become an increasingly lawless place. Worse, Ingushetia is in a state of near-anarchy, with Russian security services using the same brutal methods as armed Ingush rebels.

But it is the three countries of the south Caucasus—Georgia, Azerbaijan and Armenia—that are the bigger story now, for they are the cockpit in a new clash between Russia and the West. The main reason these tiny countries matter, despite a combined population of only 16m or so, is geographical. Perched next to Turkey, north of Iran and south of Russia, this is a place where empires have long met—and clashed. Russia never reconciled itself to losing control of the Caucasus when the Soviet Union broke up in 1990-91. Moscow has been visibly fretful about rising Western influence.

The Russians have been especially hostile to Georgia's president, Mikheil Saakashvili, who swept to power after ousting Eduard Shevardnadze in the "rose revolution" of 2003. Indeed, the icy personal relations between Mr Saakashvili and Russia's Vladimir Putin have clouded the whole region. The Russians have kept up a trade and travel embargo on Georgia. They were incensed by NATO's decision in April that Georgia should one day be a member, even if the country was not offered an immediate "membership action plan".

Russia is less neuralgic about the other two Caucasus countries, where its influence is stronger. Yet in many ways Azerbaijan matters more than Georgia, as it has lots of oil and gas (Georgia and Armenia have plenty of minerals, but little energy). The whole area is crucial for existing and planned pipelines, especially for gas, that can supply Europe while bypassing Russia (see map). Pipelines go a long way towards explaining why the Caucasus is now such a critical theatre in Russia's face-off with the West.

The third reason why the Caucasus matters is that it harbours several simmering conflicts left after the collapse of the Soviet Union in 1991. Indeed, most of the fighting then took place in the Caucasus. Georgia was left with two regions, Abkhazia and South Ossetia, that broke free of Tbilisi's control in two wars in the early 1990s. As became clear in August, Russia sustains their independence from the irritating Mr Saakashvili. Azerbaijan has the autonomous region of Nagorno-Karabakh, over which it fought and lost an even bloodier war with Armenia in 1991-94. Today Armenia controls not only Nagorno-Karabakh but also seven villages in Azerbaijan proper, and soldiers are frequently killed along the ceasefire line.

Marching through Georgia

It was on August 7th that the world woke up to the dangers of the Caucasus's territorial conflicts. For months the Russians had done their utmost to provoke the Georgian president, who has a reputation as a hothead. Bombs were dropped, drones sent over Georgian territory, invasion exercises staged. The Americans insist they were urging restraint on Mr Saakashvili, but some observers claim the signals were mixed. After all, Mr Saakashvili had promised to restore Georgia's territorial integrity; and he also seized a smaller rebellious enclave, Ajaria, in 2004. He may have banked on doing the same in South Ossetia without either American objections or a determined Russian response.

Tension rose steadily during the week leading up to August 7th. Indeed, Paata Zakareishvili, a close observer of the enclaves, believes that war could have broken out on any day that week. Yet what actually happened on August 7th remains a matter of fierce dispute—and may be the subject of an international inquiry that Mr Saakashvili says he would welcome, and claims he was the first to call for.

The Georgian version of events goes like this. After several days of skirmishes with South Ossetian forces, Mr Saakashvili announced a ceasefire, which he says was violated by the Ossetians. But he decided to shell and then invade Tskhinvali, the South Ossetian capital, only once Russian troops and tanks started pouring in from North Ossetia through the Roki tunnel on the evening of August 7th. The Russians insist that no troops entered the tunnel and that the attack on Tskhinvali was unprovoked (monitors from the Organisation for Security and Co-operation in Europe, trapped in Tskhinvali, say that they heard no Ossetian shelling before the Georgians opened up). At the time the Russians also asserted that 2,000 people had been killed in the city and talked wildly of genocide (the true number seems to be little more than 100).

The Russians responded with massive force. Although they took heavy casualties from the Georgians as their columns drove south, sheer numbers eventually told and the Georgians were pushed back before abandoning the fight. The Russians then occupied swathes of territory around the enclaves and briefly threatened Tbilisi before declaring a ceasefire. Yet for weeks after they first promised the European Union that they would withdraw from Georgia proper, the Russians kept their troops and checkpoints on the thin excuse of taking “security measures”. These forces smashed up Georgian bases, ports, railways and roads.

The Russians have just declared that they have fulfilled their most recent promise to the EU to pull out of Georgia proper by October 10th. Yet their troops are in places where they were not before August 7th, and there are far more of them. Georgian villages in and near South Ossetia have been subjected to brutal ethnic cleansing. And the Abkhaz have taken back the Kodori gorge from Georgian forces. This is a long way from restoring the status quo before August 7th. The short August war has also left Georgia with the burden of as many as 60,000 refugees.

The EU has now deployed some 200 ceasefire monitors, but the Russians will not let them into the two enclaves, which they have unilaterally recognised as independent states. Talks over the enclaves’ status began in Geneva this week but broke up almost immediately, when the Russians walked out. Agreement was clearly impossible. The Russians think they won the war and should reap the rewards. The Georgians cannot let go of the enclaves. Even Nino Burjanadze, a former speaker of the Georgian parliament who is now an opponent of Mr Saakashvili’s, says this would be like cutting off one’s arms and legs.

One effect of the war was to dampen Georgia’s soaring economy. Real GDP rose by over 12% in 2007, thanks to a surge in foreign investment, a liberalisation programme and a curbing of once-endemic corruption. Mr Saakashvili says that, if the war had happened just two years ago, the economy would have collapsed. Now, he notes with satisfaction, Russian financial markets have suffered the bigger falls. Admittedly, growth looks like lapsing to 5% or less this year, not least because of a bleaker world economic outlook; but reconstruction work and a promised inflow of foreign aid should push it up next year.

The political prospects in Georgia are murkier. Although Mr Saakashvili likes to say that the best response to Russia’s aggression is more democracy, he has yet to translate his words into action. He did himself no favours by crushing opposition protests in Tbilisi last November. He was re-elected president in January, and his party won the parliamentary election in May. But the opposition is regrouping. Ms Burjanadze plans to form a new party. More critics of Mr Saakashvili’s warmongering venture into South Ossetia and his autocratic instincts are emerging: Georgia’s ombudsman recently called for “real democracy” to replace authoritarianism. Ironically it is the Russians, who most want to get rid of Mr Saakashvili, who are now his biggest prop: since the war, his popularity rating has risen to over 75%.

Even today, Mr Saakashvili claims to regret nothing; he maintains that he had no alternative and that the war was not really about South Ossetia and Abkhazia at all. Indeed, he barely accepts that Georgia lost. As he sees it, the Russians already controlled both enclaves; his government has not fallen; vital pipelines across Georgia were undamaged despite Russian bombing; and the economy is holding up. And he revels in the world’s attention. When Georgia was overrun by bigger neighbours in the past, he says, nobody paid any heed; this time, leaders from all over Europe flocked to Tbilisi to show their support.

The oil-and-gas game

The August war has profoundly affected Azerbaijan and Armenia too. Neither is anywhere near as democratic as Georgia, both are friendlier to Russia (Armenia, in particular, is a close ally) and neither aspires yet to join Western clubs like NATO or the EU. Yet, in the war’s aftermath, both are looking to the West more than before.

Azerbaijan’s president, Ilham Aliev, predictably won re-election on October 15th, in part because most opposition candidates boycotted the poll on the ground that it was neither free nor fair. An autocratic government can appear to create stability. Yet the younger Mr Aliev is widely seen as a weaker leader than his father Heidar, who bequeathed him the presidency in 2003, and some think he is in hock to the country’s most powerful business oligarchs. Opposition leaders like Eldar Namazov claim that there is even less freedom now than before.

What is certain is that Azerbaijan’s oil-fired economy has been booming. As one diplomat says, it feels and looks a bit like a slightly seedy Gulf emirate. The Baku-Tbilisi-Ceyhan pipeline is now shipping 1m

barrels of oil a day; gas is flowing to Georgia, Turkey and Russia. Baku is smothered in petrodollars, with glitzy new buildings and horrendous traffic jams. It is less clear that ordinary citizens are benefiting. Many complain about inflation, which is running anywhere between 16% (officially) and 30% (say some economists). The government talks up its programme of economic liberalisation, which has been praised by the World Bank. Yet Azerbaijan also has a reputation for corruption.

There is a big downside to the oil boom: it crushes the non-oil economy. One economist says that oil and gas now account for half of GDP and over 90% of exports. The real exchange rate has appreciated sharply, one reason why Baku is so expensive. Worse, oil and gas reserves in Azerbaijani territory are finite. Bill Schrader, head of BP Azerbaijan, notes that the real game for the future will be to try to tap into the Turkmenistan side of the Caspian, which has huge reserves of gas.

Azerbaijan's energy wealth is naturally of interest to the Russians, who want it to sell more oil and gas northwards. Russia's energy giant, Gazprom, is desperate for more gas. But the government is having none of it: it supplies Georgia with gas against Russia's wishes, for example, and it is enthusiastic about pipelines to the West (including the planned Nabucco pipeline). Officials see big advantages in not depending on a single buyer.

Looking for allies

Another big cloud on the horizon is Nagorno-Karabakh. Negotiations over the Armenian-controlled territory continue fitfully in the so-called Minsk group led by Russia, America and France. Until the war in Georgia, observers were worried that a newly rich Azerbaijan, which is spending heavily on defence, might again resort to force. Ordinary Azerbaijanis, angry that one-seventh of their country is occupied by Armenia, remain belligerent. But after Georgia a new war looks less, not more, likely, not least because the Russians would not allow Armenia, their ally and host to two big military bases, to be beaten.

Yet the Armenians are not complacent. Russia's war with Georgia made this tiny landlocked country feel highly vulnerable. Its eastern border with Azerbaijan has been blocked by the aftermath of the 1991-94 war, and the Turks sealed their western border in 1993 in sympathy with their Azeri cousins. Some 80% of Armenia's trade goes through ports in Georgia, many of which were damaged by the Russians. Not surprisingly, the Armenians are looking around for more friends in the neighbourhood besides Russia. A new gas pipeline from Iran is planned, for instance.

Armenia is hardly less autocratic than Azerbaijan. The election in February that brought Serzh Sargsyan into the presidency was criticised by most Western monitors. Worse, the opposition leader (and former president), Levon Ter-Petrossian, who says roundly that the election was stolen, took his followers on to the streets. The result was the most violent protests Yerevan has ever seen, put down by the government with the loss of eight lives. As many as 74 opposition demonstrators remain in jail, although Mr Sargsyan blandly assures interlocutors that there are no political prisoners in Armenia.

As in the rest of the Caucasus, the economy has done well in recent years, although it is over-dependent on raw materials, construction and diamond-trading, plus remittances from the large Armenian diaspora. It is also the diaspora that bangs the drum most loudly against a diplomatic settlement of Karabakh or any improvement of relations with Turkey. Yet Mr Sargsyan is being bolder than his predecessor-turned-critic, Robert Kocharian. Both men come from Nagorno-Karabakh, so they are hardly likely to let go of the Armenian-populated enclave. But Mr Sargsyan is readier to negotiate and to give back most Armenian-controlled territory in Azerbaijan outside Nagorno-Karabakh. Even that may not be enough to settle the dispute, for this would require Azerbaijan to accept the de facto independence of Karabakh.

Reuters

Saakashvili, shaken but not stirred

The other two reasons for mild hope concern Turkey. Mr Sargsyan bravely invited the Turkish president, Abdullah Gul, to a football match in early September. Talks between the two foreign ministers took place in New York three weeks later. The aim, as Edward Nalbandian, the Armenian foreign minister, puts it, is to achieve "total normalisation" of relations with Turkey. On the Armenian side, that means dropping all preconditions, including demands that Turkey accept that there was an Armenian genocide in 1915. Mr Sargsyan has gingerly expressed support

instead for a Turkish idea that the subject should be looked at by a joint historical commission.

The push to reopen the border with Turkey is clearly driven in part by Georgia's war with Russia. But there is a long way to go before inhabitants of Yerevan can cross the border to their sacred Mount Ararat. As always, some businessmen benefit from its closure. Moreover, Karabakh will be a continuing sore: on the Armenian side, some may prefer stasis on Karabakh to normal relations with Turkey, while the Azerbaijanis, who have great influence in Turkey, will do their utmost to upset friendlier links between Turkey and Armenia.

A Western opportunity

To outsiders, the Caucasus often seems a hotbed of devilish intrigue, power games and insoluble ethnic conflict. The war in Georgia confirmed the worst suspicions of many. Yet both in Georgia and in its two neighbours, it could also have created an opportunity for change.

For all his bravado, Mr Saakashvili was clearly shaken. He should now be more amenable to the line that the best way to promote Georgia's integrity is to foster a genuinely liberal democracy—so that, one day, the enclaves might choose to return. A similar argument could carry some force in Azerbaijan and Armenia as they look for friends beyond Russia. If the West is to be consistent, however, it should support these countries only in so far as they take steps, however slowly, in the same democratic direction as Georgia.

Two keys could help to unlock this process. The first is to dangle the prospect, however distant, that all three countries might one day qualify as members of the EU. As experience in eastern Europe has shown, this is the best way to lure countries towards reform. The EU may offer a better route than NATO membership, which is both more problematic and further off after Georgia's war.

The second key is to work with Turkey, which as the only NATO country in the region is well-placed to offset Russia's influence. Shortly after the war, Turkey launched a proposed "Caucasus Stability and Co-operation Platform", which even the Russians applauded. Turkish companies are active in the region, conspicuously so in Georgia and Azerbaijan and (in disguise) even in Armenia. If the Turks can improve relations with Armenia, including opening the border, they could play a more constructive role in the Caucasus than the Russians have ever done.

But both Turkey and the three Caucasus countries will need encouragement. That could start with a firm EU decision to back the Nabucco gas pipeline. It would also help if the Caucasus countries were less nationalist and better at working together. Paradoxically, Georgia's war with Russia may enhance the chances of peaceful progress in the whole region.

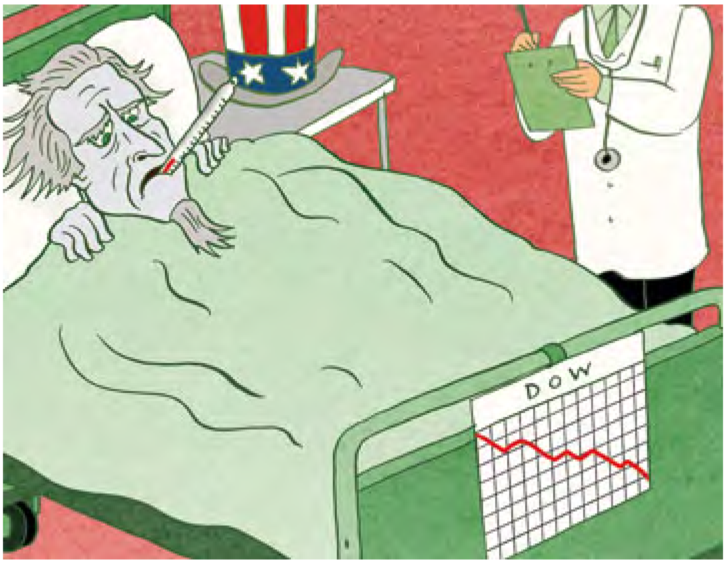
Health care

In need of desperate remedies

Oct 16th 2008 | NEW YORK
From The Economist print edition

Could the financial crisis speed efforts to reform America's troubled health system?

Illustration by S. Kambayashi



TOMMY THOMPSON, a former secretary of health who made his name spearheading health and welfare reforms when he ran Wisconsin, is convinced that "2009 will be the biggest year for the transformation of health care." On the face of it, it seems a strange assertion, given the global financial mess that is sure to dominate the next president's first year.

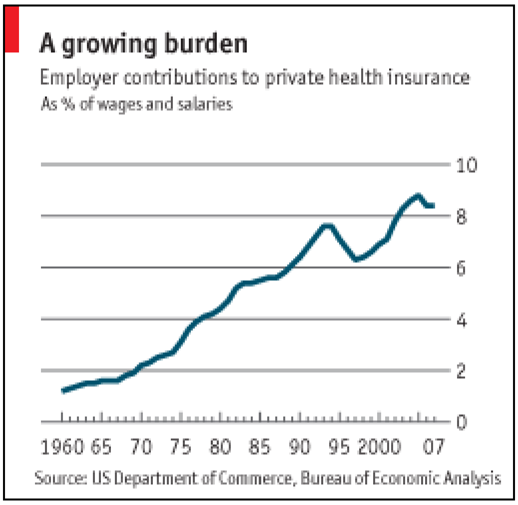
After all, that financial panic shows obvious signs of spreading into the real economy, as the parlous state of Detroit's car manufacturers makes clear (see article). But soaring health costs are one of the big factors that have brought those car firms to the brink in the first place. Detroit's automobile manufacturers claim they spend over $1,500 per car on health costs, far more than is paid by foreign firms from countries with taxpayer-funded health care. So a coming recession may end up as a powerful impetus for health reform.

Thanks to a pact made by big business and labour half a century ago, most Americans receive their health coverage through their employers. Government has encouraged this compact by not classing company-provided health cover as a taxable benefit; people who buy their own, by contrast, have to do so with post-tax dollars. Economists criticise this tax concession, which is reckoned to cost the federal exchequer over $200 billion, for a variety of reasons: it favours the rich, discriminates against the self-employed and hinders labour mobility.

But companies are starting to rebel. Tax break or no tax break, increases in health costs, which have long outpaced inflation, have meant that employers are spending ever greater amounts on providing cover. Those costs have nearly doubled this decade alone, and a new report by Towers Perrin, a benefits consultancy, forecasts they will surge by another 6% in 2009. This, firms argue, burdens them with unfair costs. "The price tag for this care makes many American goods and services relatively more expensive," complains the National Business Group on Health (NBGH), which represents many of the country's biggest employers.

It is quite a U-turn for big business to go from undermining Hillary Clinton's attempts at providing health cover for everyone in the 1990s to lobbying for a government role in health reform. Mark Smith, the head of the California HealthCare Foundation, a

charity, worked in the Clinton administration on that ill-fated plan. Back then, he observes, business leaders were so suspicious of government that they fought the plan, even though it would have reduced the burden on industry. Ironically, firms ranging from Wal-Mart to Detroit's car manufacturers today think "only the government can save us."



Not everyone buys industry's arguments about rising health costs imposing a competitive disadvantage on firms. Conventional economic theory maintains that firms should be indifferent to whether they pay employees cash wages or benefits. The two are seen as fungible, and are both tax deductible. So if the cost of health benefits rises, employers ought to be able simply to cut wages—or pass on those costs as higher prices to customers.

This theory is correct over the long term but falls apart in the short term, argues Len Nichols of the New America Foundation, a Washington, DC-based think-tank. In competitive global markets, firms usually cannot pass on health costs as easily as price increases since rivals overseas do not pay nearly as much via taxes to support state health systems.

And many firms cannot simply slash wages to offset increases in health costs. Employees guard their salaries more fiercely than other benefits and unions still have clout. Towers Perrin calculates that employers are therefore being forced to absorb about four-fifths of the increase in health costs. Soaring health costs depress wages below where they would otherwise be, and make for a sicker, more disgruntled workforce and poor labour relations.

What, then, to do? The boldest idea for reform now gaining currency is to abolish the tax advantage enjoyed by employer-based health cover. For decades, this was taboo, but no longer. First, John McCain has made abolishing this tax distortion the centrepiece of his health plan—though his ideas on what happens after the current system is abolished are rather less coherent. The New America Foundation has also recently proposed a variation on this that would cap the current tax deduction so that the wealthiest can no longer enjoy tax breaks for sumptuous so-called Cadillac plans.

A more comprehensive proposal comes from Senator Ron Wyden, a Democrat from Oregon whose Healthy Americans Act (HAA) would scrap the tax benefit and replace it with a fixed tax deduction for employees so that they could, as with Mr McCain's plan, buy coverage from either private or public sources. But this plan goes further to address likely market failures. The HAA imposes an individual requirement to purchase insurance, offers subsidies for the poor and sets up state-run insurance pools that should keep premiums down. It also demands that employers giving up health coverage convert health benefits into wages.

Cherry picking, lemon dropping

Because the HAA harnesses the vast pool of money that is today distributed inefficiently through the tax break for employer-provided care, and then couples it with clever cost-control mechanisms, the Congressional Budget Office and the Joint Committee on Taxation have judged that the HAA will be revenue neutral or even revenue-enhancing within a few years. This is more than can be said for Barack Obama's plan, which would expand coverage, but at a hefty cost. It has helped the HAA win the support of a bipartisan group of 16 senators, including such Republican budget hawks as Judd Gregg. Even the American Medical Association, the lobbying group for doctors that has been extremely wary of reforms, threw its weight behind the HAA in September.

The attraction of a coherent, fiscally sound, bipartisan reform—be that the HAA or some variant on it—is great. But given the thorny politics and vested interests involved in a sector making up roughly a sixth of the American economy, the odds are still stacked against it.

An alternative might come from state-led experiments. For instance, Massachusetts is trying to achieve universal coverage first before tackling costs. Critics complain that the scheme's total costs have been higher than expected, but the flip side has been a dramatic expansion of coverage at a relatively low cost per head. The federal government has just given its vote of confidence to this state effort, agreeing on September 30th to a three-year deal that will provide $10.6 billion in federal money to support the state's experiment.

Another possible way forward is the incremental approach. Mr Thompson thinks there is enough consensus in Washington, DC, to take modest but useful steps towards making greater use of IT in health care ("e-prescribing", for instance) and to reform the way chronic diseases such as diabetes are treated.

David Snow, the boss of Medco, a giant "pharmacy benefits manager" or drugs middleman, put forward his own plan in September for five discrete reforms that he thinks can squeeze $1 trillion in costs out of the system over time: more information technology, fixing Medicare's financial health, reforming medical liability laws, reducing medical errors and promoting prevention. Hardly an original list, but the problems are well known.

In sum, there is something new under the sun. After decades of dawdling and delay, it seems America may finally be coming to grips with the health system's runaway costs. The coming economic difficulties may help, both by forcing politicians to rise above petty politics to pay attention to serious issues like health reform—and by limiting the menu of options they have for pursuing such reform.

The candidates and the economy

A plethora of plans

Oct 16th 2008 | WASHINGTON, DC
From The Economist print edition

Cost is no object for two candidates eager to help

AMERICA'S presidential candidates have declared war on recession. Last week saw John McCain issue his "American Homeownership Resurgence Plan"; this week came his "Pension and Family Security Plan", and Barack Obama's "Rescue Plan for the Middle Class". With less than a month to go before the election and the economy at the top of Americans' minds, both candidates have apparently forsaken efficiency and thrift, adding lots of new goodies to their economic programmes in order to help those they deem hardest hit. That group, according to Doug Holtz-Eakin, Mr McCain's principal economics adviser, includes "seniors, savers, workers, people trying to get to college". In other words, pretty much everyone.

The bulk of the spending Mr McCain proposed on October 14th—$36 billion—is for temporarily lowering taxes on old people withdrawing money from their retirement accounts, which, the Obama camp points out, will mainly benefit the wealthy. Rather jarringly, at the same time Mr McCain wants to try and shore up equities markets by halving taxes on capital gains for two years. (Mr Obama's people observe that not too many people will be recording capital gains this year.) A week earlier, Mr McCain had announced that he wants the government to spend $300 billion buying troubled mortgages at face value—an expensive way to save homeowners, and rather unfair to those who have already sold their mortgages under harsher terms.

Until this week, Mr Obama had resisted tossing out grand new plans of his own for economic rescue, making Mr McCain look a little desperate when he did so during a presidential debate on October 7th. But on October 13th the Democrat upped the ante. The priciest part of Mr Obama's new two-year plan would be a $3,000 tax credit for each new employee a business hires, which presumably is likely to benefit a lot of companies that would be hiring anyway. Mr Obama also wants to allow everyone to withdraw up to $10,000 from their retirement accounts tax-free (as with the McCain version, not a good way to encourage saving), and he wants a 90-day moratorium on home foreclosures. Such indiscriminate intervention in the mortgage market may be very nice for homeowners whose prospects are looking up, but it would do little in itself for those who can't afford their mortgages in the first place.

Both plans are costly. Long before this week, Mr Obama had proposed sending cheques to the middle class, to be partially paid for with a tax on oil companies' "windfall profits". But with the collapsing price of crude, the package's net cost has now shot up from $50 billion to $115 billion. Jason Furman, Mr Obama's economics director, estimates the latest round of proposals will take that up to $175 billion over the next two years. Mr McCain's pre-existing tax plans would have caused the deficit to balloon more than Mr Obama's, and his campaign says his latest proposals will cost another $53 billion. The timing is awful: the Treasury announced on October 14th that the government's fiscal 2008 deficit was $455 billion, not the $389 billion projected in July.

Candidates promise a lot of things that never come to pass. A President McCain would certainly face a sceptical Congress. But Democratic lawmakers are already talking about calling a lame-duck session shortly after the election to pass more economic stimulus packages. Chuck Schumer, a senator from New York, says that if the Democrats win big, even outgoing Republicans will "smell the coffee". Some of Mr Obama's ideas, so Mr Furman hopes, might even become law before he enters the White House.

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WORLD
UNITED STATES

Presidential debates

The last word

Oct 16th 2008 | WASHINGTON, DC
From The Economist print edition

The final contest was the best by far

Getty Images

Plenty to smile about

THE third and final debate, which took place at Hofstra University, New York on October 15th, was a firecracker of a show, as riveting as the two previous meetings were soporific. The candidates discussed substantive issues. They exchanged sharp blows. And, most of the time, they avoided reciting their talking points.

Some of the credit for this belongs to the moderator, Bob Schieffer, a CBS News anchor, who asked serious questions and even, occasionally, upbraided the candidates for not answering them. But most of it belongs to John McCain. Mr McCain knew that this was his last best chance to do something dramatic to shake up a race that is threatening to turn into a rout—and he came out swinging, pummelling away at Mr Obama for all he was worth.

Mr McCain drew sharp contrasts with his opponent. He insisted that Mr Obama believes that the government has the answers to America's problems, whereas Mr McCain puts his trust in ordinary people (in one amusing slip of the tongue he seemed to address Mr Obama as "Senator Government"). He dwelt at length on an offhand comment that Mr Obama made to a small-businessman called Joe the Plumber about "spreading the wealth about", instantly turning Joe into the most famous plumber since the operatives who broke into the Watergate complex.

Mr McCain managed to land some good jabs on his rival. He pointed out that he had broken his promise to take public financing for his campaign (and thus limit campaign spending). He noted that Mr Obama's solution to every problem is to spend more money. He attacked Mr Obama for (unfairly) pretending that there is no difference between him and the present incumbent. "I am not President Bush," he said at one point. "If you wanted to run against President Bush you should have run four years ago."

All good stuff. But Mr McCain also made two big mistakes. Bringing up Mr Obama's association with Bill Ayers, a former terrorist, made him look petty on a day on which the Dow Jones had lost 8% of its value and people have much bleaker issues on their minds. The second—and more serious—lay in his body language. Mr McCain let his contempt for the younger man shine through, harrumphing, grimacing, smirking and goggling his eyes whenever Mr Obama got a chance to speak. The whole performance was reminiscent of Al Gore's sighing in his debate with George Bush in 2000, which many people think contributed to his defeat.

Mr Obama's performance during all this was remarkable. He remained calm and unflustered. He listened

respectfully to his opponent. He took every opportunity to change the subject to economics and the woes of the average American. He even turned Mr McCain's assertion that he associated with Mr Ayers to his advantage, claiming that the people he associates with, on economic issues, are Paul Volcker and Warren Buffett. If many of his arguments were weak—he gave no sense of how he would reconcile his spending plans with America's giant deficits—his body language was impeccable.

The instant polls all gave a big victory to Mr Obama. Mr McCain made the debate exciting, but Mr Obama got the better of the evening, surely increasing his already high chances of victory in November.

Campaign advertising

Full of sound and fury

Oct 16th 2008 | RICHMOND, VIRGINIA
From The Economist print edition

The mud is flying, but it probably won't affect the outcome of the election

AT THE beginning of this month, millions of Americans got letters boosting Barack Obama. Unlike most political messages, these were turgidly written, scrupulously accurate and did not cost the candidate's campaign a penny. Yet they helped Mr Obama double his lead over John McCain, to 8% in national polls. They were quarterly reports telling Americans what had happened to their savings invested in the stockmarket, and they have been more effective than any campaign ad.

But both campaigns have been tossing the mud regardless. To date, 73% of Mr McCain's ads and 61% of Mr Obama's have been negative, says the Wisconsin Advertising Project, which monitors such things. John Geer, the author of a book called "In Defence of Negativity", thinks negative campaign ads are more informative than positive ones. But this is not saying much.

Mr Obama's ads attack Mr McCain for the many ways he plans to make life wretched for nearly everyone. One claims that, had Mr McCain had his way, your pension might have been invested at Lehman Brothers. The insinuation is that you would have lost it all. The supposed evidence for this claim is that Mr McCain favours allowing people to invest some of their Social Security payments in the stockmarket. Other Obama spots depict Mr McCain palling around with George Bush, predicting that the Iraq war would be easy and telling "despicable" and "disgusting" lies about Mr Obama.

Mr McCain's attacks on Mr Obama focus on his slender résumé, his dodgy associates and the possibility that he will raise taxes. The spot that Republicans say best captured Mr Obama's ratio of fame to accomplishment was an early one likening him to Paris Hilton. More recent ones highlight Mr Obama's ties to Bill Ayers (an unrepentant bomber of American government buildings), Tony Rezko (a fraudster) and ACORN (see article). Much to the irritation of his fellow Republicans, however, Mr McCain has not gone after Mr Obama's former pastor, Jeremiah Wright, of "God damn America" fame, perhaps for fear of being branded a racist.

Mr Obama has far more cash with which to spread his message. Last week in hotly-contested Virginia, for example, he spent eight times as much as Mr McCain on ads. On October 29th, the anniversary of the crash of 1929, he plans a monster half-hour slot. His campaign is also savvier about technology. It posts long ads on its website, such as a recent 13-minute one about Mr McCain's involvement in the savings-and-loan scandal of the 1980s. It e-mails supporters with links to new footage and instructions to spread the word. It has even placed ads in video games. Mr McCain uses the internet primarily to save money. His campaign posts controversial ads online, rather than broadcasting them, in the hope that news channels will report on them, broadcasting them for nothing.

Some Democrats complain that Mr McCain's attacks are stoking up violent racial hatred against Mr Obama. John Lewis, a congressman, likened Mr McCain to a segregationist governor of Alabama whose rhetoric led to four black girls being murdered in a church bombing in the 1960s. The *New York Times* frets about the "Weimar-like rage at McCain-Palin rallies". The main evidence for this is that someone reportedly shouted "Kill him!", possibly referring to Bill Ayers, possibly to Mr Obama, at a recent event for Sarah Palin.

But predictions of impending violence are unfounded. It is easy to find a few crazies at any rally. They often wear T-shirts advertising their craziness. At a Palin rally this week in Richmond, Virginia, this correspondent met a man who thought Mr Obama might be the Antichrist "without knowing it". But the other 20,000 or so people there seemed boringly normal, and everyone behaved impeccably.

Fact-checking

Fire-fighters for pants

Oct 16th 2008
From The Economist print edition

But who will check the checkers?

BOTH candidates "are flinging rather a lot of political poppycock," says FactCheck.org, a website that does what it says it does. John McCain will cut your pension. Barack Obama does not take the Iranian threat seriously. These are just two of the whoppers that a growing swarm of fact-checkers have unearthed this year. PolitiFact.com offers a handy Truth-O-Meter, with a dial going from "true" to "pants-on-fire". That ought to lead to a better-informed electorate.

But fact-checkers have their limits. Politicians are not stupid; they leave themselves wiggle room. In a typical ad, every sentence is true, even if the overall impression is misleading. One of Mr Obama's, for example, talks of a factory closing in Pennsylvania and its equipment being shipped to China. Mr McCain "sold out" the workers, the ad claims. He voted against cracking down on China's unfair trade practices. In fact, the factory closed because it made cathode ray tubes, which no one wants any more, and the "equipment" was only spare parts. So Mr Obama is talking poppycock when he blames Mr McCain for lost jobs. But is he lying?

Fact-checkers sometimes disagree. When Mr McCain said he stood up to Ronald Reagan over sending marines to Beirut, CNN's fact-checkers concluded this was true, while ABC's deemed it false. The marines were already in Lebanon when Mr McCain became a congressman; he voted against extending their deployment.

Because fact-checkers must make subjective judgments, the *Wall Street Journal* prays that the fact-checking fad will "soon go the way of streaking and Mexican jumping beans". But this is too harsh. Fact-checkers sometimes prompt candidates to correct themselves. Mr McCain used to accuse Mr Obama of voting to raise taxes on families earning as little as $32,000. The true figure, said FactCheck.org, is $42,000. So that is what Mr McCain now says. And that's a fact.

ACORN

Mickey Mouse for Obama?

Oct 16th 2008 | AUSTIN
From The Economist print edition

A rash of fraudulent registrations

AP

Register early, register often

INTEREST in the upcoming election is running high, and officials around the country have reported big surges in voter registration. But some of the new applicants do not pass muster. In Orlando, home to the Magic Kingdom of Disney, Mickey Mouse tried to register. In Indiana there was an application from a sandwich shop called Jimmy Johns. Authorities in Nevada were surprised to receive voter registration forms from the starting line-up of the Dallas Cowboys.

All these applications were provided by the Association of Community Organisations for Reform Now (ACORN), a group that works to register low-income voters. ACORN has been industrious this year, signing up 1.3m voters in 21 states according to its own tallies. But they have run into some trouble; thousands of their voter-registration applications are fakes. In Connecticut a seven-year-old girl applied. A man in Ohio admitted he had signed up with organisers more than 70 times in exchange for cash and cigarettes. In one county in Indiana ACORN turned in 5,000 applications, 2,100 of which were quickly identified as fakes.

ACORN's defenders protest that they are the victim of a few bad apples. Some of its workers, they maintain, find it easier to crib names from the phone book than to trawl around looking for real voters. And once the forms are filled out, ACORN has to turn them in. Most states have laws requiring as much, so that partisan workers cannot bin any applications out of personal prejudice. In fact, claims ACORN, they make an effort to label the obviously fake ballots as such.

But Republicans are crying foul. They say that ACORN is a shady group working to steal the presidential election on behalf of Barack Obama. The plot thickens: Mr Obama led training sessions for the group back in his Chicago community-organiser days, and his campaign has had some dealings with it.

Still, voting fraud on an election-changing scale seems unlikely, and unnecessary too, given the huge margins that Mr Obama is racking up in many states. To pull it off in the way ACORN is being accused of, a schemer would have to get many thousands of fake registrations past the officials. Then the actual ballots would have to be cast, which would require thousands of impersonators actually to turn up and vote. (Fraudulent absentee ballots, which could be mailed in, are a different proposition, and are subject to their own checks.) The evidence tends to suggest that ACORN has some bad management flaws, not that it is some kind of massive and mildly incompetent conspiracy.

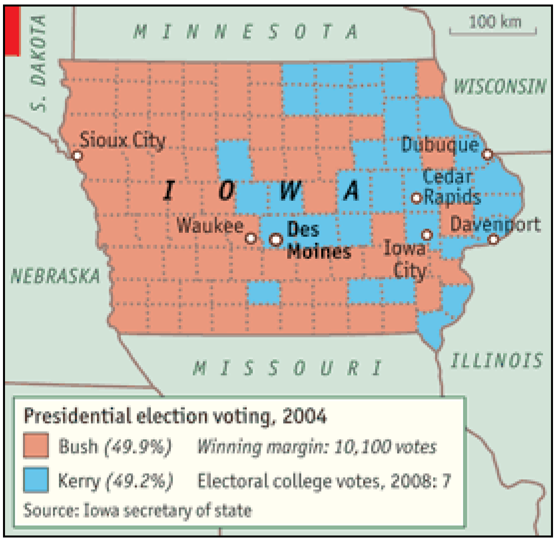
Of course, the fraudulent registrations are a problem. They gum up the process and open the door to legal complaints. In Ohio, Democrats and Republicans are going at it in court over the best way to flag up irregularities. Everyone wants to avoid having a swing state settled by judges.

Swing states: Iowa

Reaping what you sow

Oct 16th 2008 | WAUKEE
From The Economist print edition

Barack Obama looks certain to flip the Hawkeye State



IOWA, according to most polls, is the swing state that has most definitively swung. In 2000 Al Gore won its seven electoral votes by 0.3 percentage points; George Bush won them by 0.7 points in 2004. But Barack Obama currently leads John McCain by about 12 points. The McCain campaign insists the race is closer than that, and Mr McCain visited the state on October 11th and twice in September. His efforts are unlikely to be enough.

Mr McCain has the same problems in Iowa as he does in other states. The financial crisis has boosted support for his opponent. His campaign in Iowa, as elsewhere, has also shown signs of chaos. A pastor recently launched a rally at Davenport by saying that Muslims, Buddhists and Hindus were praying for Mr Obama to win. (The campaign hastily rebutted this.) One party volunteer there told *The Economist* that Mr Obama might be “part of a terrorist plan to take over our country.”

These dynamics are, for better or worse, at play across the country. But several factors make Iowa a particularly thorny state for Mr McCain. First, Iowa has been turning steadily to the left. In 2006 Democrats won majorities in the state House and state Senate. They also seized two congressional seats that had been held by Republicans since the 1970s.

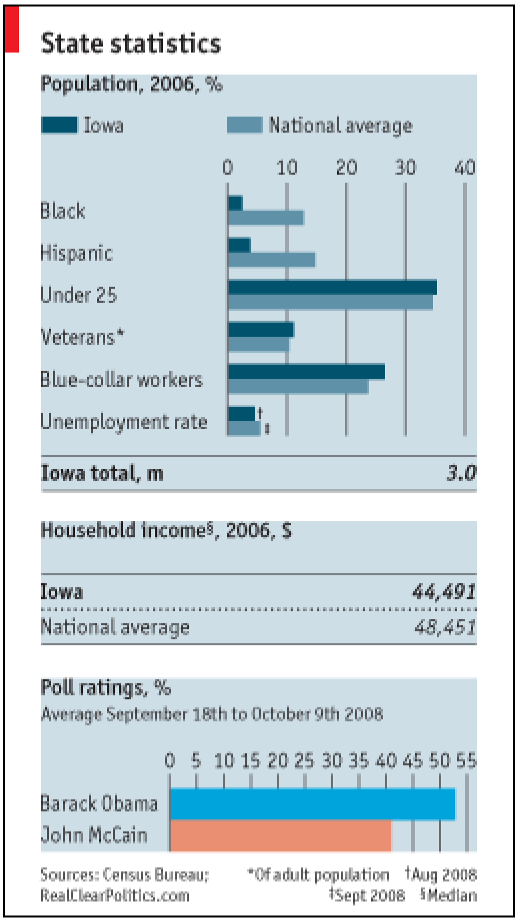
Second, Mr Obama is beloved in Iowa. After he announced his candidacy in Illinois, he travelled immediately across the state border to campaign in Iowa. He returned again and again, often to hostile territory, and built a huge campaign machine. These efforts paid off in the caucuses. Mr Obama won Iowa, the first contest, proclaiming: “On this January night, at this defining moment in history, you have done what the cynics said we could not do.” Mr McCain flailed in comparison. When Mr Obama was traversing the state in mid-2007, Mr McCain was running out of cash and spending resources elsewhere. He came fourth in the Republican caucuses.

The third factor helping Mr Obama is that he has diligently wooed rural voters; he has 50 offices in Iowa compared to Mr McCain’s 16. Last October he unveiled a rural strategy, which includes encouraging young farmers, supporting rural businesses and improving rural health care. Though he wants to cap farm payments at $250,000, he voted for the recent farm bill and favours subsidies for ethanol. Mr McCain has pursued a principled but suicidal strategy. An easy way to alienate the largest corn-producing state in the union is to say that you would veto the subsidy-stuffed farm bill “in a New York minute”.

Most Iowans live in the eastern half of the state, clustered around cities such as Des Moines and Cedar Rapids. But Mr Obama's rural strategy has been important. The Obama campaign sees rural voters, who comprise 40% of Iowa's voting-age population, as ripe for the picking. "You do not need to win these areas," explains Chris Petersen, the head of the Iowa Farmers Union. "You just need to win a bigger percentage."

Mr Obama's agricultural policies also resonate beyond rural counties. Farming and farm-related manufacturing have helped buoy Iowa's economy. It is hard to ignore the importance of agriculture, even in the state's developed areas. Waukee, for instance, has a giant grain elevator beside its tidy subdivisions. The main road glides quickly from strip malls to a wide gold sea. But though farming has ensured that Iowa is no Michigan, the state is not immune from economic downturn. Corn prices have halved since June. State revenues are projected to flatten over the next two years. Jackie Norris, Mr Obama's state director, contends that Mr McCain "has not been good to the things that have been good to Iowa".

Stewart Iverson, chairman of the state's Republican Party, insists that Mr McCain still has "a decent shot". Sarah Palin has energised the socially-conservative western part of the state. But time is running out. As the setting sun casts a rosy wash over the fields around Waukee, the corn stalks tinged pink, the barns cutting dark silhouettes on the horizon, it looks as though Mr Obama will reap his harvest.



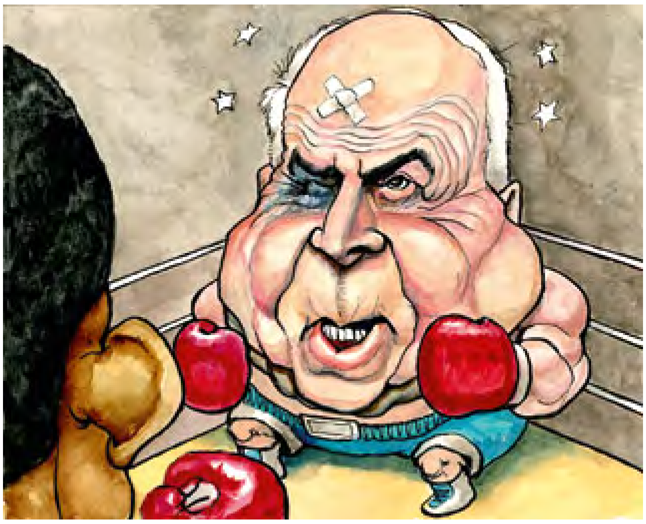
Lexington

John McCain's last chance

Oct 16th 2008
From The Economist print edition

The Republican contender is losing. Here is what he needs to start saying

Illustration by KAL



JOHN McCAIN has survived political death before. In 2000 his career in presidential politics apparently died in the killing fields of South Carolina. In the summer of 2007 he was forced to sack his staff and carry his own bags. Can he play Lazarus one last time?

The odds are long. Mr McCain has been trailing Barack Obama in Gallup's tracking poll by at least seven points for the past two weeks. Mr Obama is locking up one swing state after another and threatening Mr McCain in Republican strongholds such as Virginia and North Carolina. But long is not impossible.

Ronald Reagan trailed Jimmy Carter 39% to 47% ten days before the 1980 election. An international crisis or an act of terrorism could play to Mr McCain's great strength and Mr Obama's greatest weakness. And Hillary Clinton's strong performance in the final weeks of her campaign suggests that it is possible to pop Mr Obama's balloon provided that you use the right pins.

Mr McCain needs to drop his current line of attack if he is to have any chance of doing his own popping. He needs to dump the dumb populism (even though it seems to be too late, alas, to dump the dumb populist-in-chief, Sarah Palin.) The McCain campaign has recently focused on questioning Mr Obama's patriotism, and, in particular, on tying him to Bill Ayers, a former domestic terrorist. But this has proved counterproductive. It has whipped the party's nastier element into such a frenzy that Mr McCain has been forced to calm them down. It has alienated the independents who once constituted Mr McCain's base. And it has not even gone down well with regular Republicans. Mr McCain's approval rating among Republican voters has declined since last month.

Three ways to heaven

Mr McCain needs to go in the opposite direction—and make serious arguments for serious times. Instead of Bill Ayers, Jeremiah Wright and the rest of the gang, Mr McCain should focus relentlessly on three plausible criticisms of Mr Obama.

First, Mr McCain should point out that his opponent is one of the least business-friendly Democratic candidates in a generation. The great Calvin Coolidge once said that "the business of America is business." For Mr Obama the business of America seems to be anything but. His experience of it is

limited to spending a year working for Business International, a consultancy firm subsequently bought by The Economist Group. But he quickly abandoned the commercial world because he wanted to do something nobler. Since then his experience has been limited to the world of non-profits, law firms, universities and politics.

More significant, though, is that Mr Obama has always been particularly close to two groups that are the bane of most businesspeople's lives—lawyers and trade unionists. Both Mr and Mrs Obama are lawyers. In a speech to a group of trial lawyers on September 23rd Joe Biden, Mr Obama's running-mate (and yet another lawyer) thanked God that lawyers are "corporate America's problem" and declared that there are only two groups of people that stand between "us and the barbarians at the gate—you and organised labour".

America's trade unions clearly regard an Obama administration as a golden opportunity to reverse their long-term decline: hence their willingness to spend more than $200m getting him elected. They want to get rid of secret ballots in decisions about unionisation. They also hope to get rid of right-to-work laws (22 states currently have such laws, which prohibit the "closed shop" practice of requiring workers at a particular business to belong to a union).

Second, Mr McCain should hammer away at the dangers of single-party rule in Washington, DC. The Democrats are likely to add at least another ten seats, and perhaps as many as 20, to their majority in the House. There is a real possibility that they may attain a 60-seat filibuster-proof majority in the Senate (Democrats are leading in eight Senate seats currently held by Republicans and are close in a couple of others; they control 51 of the 100 seats already). This will allow them to push through a wish-list of Democratic proposals on everything from "fair trade" to spending. The Republicans have only just started to point this out.

But Americans have a strong preference for divided government. America has only had one-party rule (with the same party controlling the White House and both chambers) for six years out of the 28 since Ronald Reagan's election in 1980—two years under Bill Clinton and four and a bit under George Bush. Mr McCain should argue forcefully that, as an experienced legislator who has worked with left-wing Democrats as well as right-wing Republicans, he will be the perfect man to check Congress where necessary and work with it where desirable.

Third, Mr McCain should point out that his opponent has never once in his career said boo to a Democratic goose. In Chicago he got on well with everybody, from the local teachers' unions to the Daley political machine. In the Senate he has voted with his party 97% of the time. He toes the most liberal line on late-term and partial-birth abortion. Even a highly experienced Democratic president with a record of bucking his party would find it hard to tame a large Democratic majority in Congress. A neophyte with a record of going along to get along could find it impossible.

These are far from watertight arguments. Mr McCain is a military man who married his money rather than made it. Mr Obama bravely took on the Clinton establishment (though he largely did it by pandering to more Democratic interest groups). But this plan of attack does at least have the virtue of appealing to widespread worries about an Obama victory rather than pandering to the foam-flecked fringe. "Vote for me to avoid the Democratic deluge" is not the most inspiring political platform in the world. But it is the only plausible one Mr McCain has left.

Canada's general election

The Conservatives by a bigger head

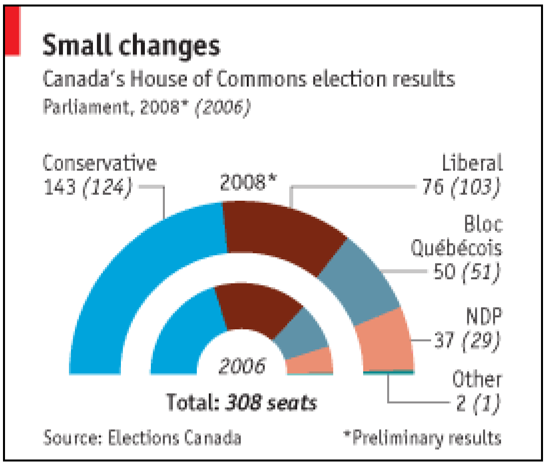
Oct 17th 2008 | OTTAWA
From The Economist print edition

A fragmented country gives another term and a bit more strength to Stephen Harper's minimalist government

Reuters

IT WAS not the result Stephen Harper had hoped for when six weeks ago he called a general election. But it was much better than the outcome he must have feared a fortnight ago, when voters seemed gripped by panic over the economy. In the event the prime minister seemed happy enough at a victory rally in his adoptive hometown of Calgary on the night of October 14th. Canadians have returned his Conservative Party to power, still with a parliamentary minority but in a much stronger position. "Our party is bigger, our support base is broader," Mr Harper told a cheering crowd. And his main opponents, the Liberals, fared so poorly that they can no longer honestly call themselves a national party.

The Conservatives increased their share of the popular vote by little more than a percentage point (to 37.6%). But that translated into 19 more seats (see chart). That is because of the country's growing political fragmentation. What was basically a two-party system has turned into one with five significant parties in a Westminster-style first-past-the-post system. The newest of the five, the Green Party, won nearly 7% of the vote, but no seats.



In victory Mr Harper struck an unusually inclusive note, promising to govern for all Canadians, set aside partisan differences to make a divided parliament work, and keep his modest campaign promises. In reality, the deteriorating economic outlook is likely to trump most election pledges. And the prime minister would not have had to promise to be nice to the opposition were it not for several campaign stumbles.

A majority was "within his reach if not in his grasp" in early September, according to Peter Donolo, a pollster. Then things began to go awry. The farm minister joked about an outbreak of food poisoning that has killed a score of Canadians. There were other minor gaffes by officials. But the most damaging missteps came from the prime minister himself. First he alienated French-speaking Quebeckers, for whom preserving their culture is important, by sneering at artists who receive government grants. That revived an old stereotype of the Conservatives as "Philistines from the west,

sweeping out of the prairies towards the outposts of civilisation in Toronto and Montreal," says Roger Gibbins of the Canada West Foundation, an Alberta think-tank. Mr Harper also seemed insensitive to public anxiety about global financial turmoil, suggesting that the crashing stockmarket offered "good buying opportunities".

In the event Mr Harper consolidated the Conservatives' solid western base of Alberta oilmen and Saskatchewan farmers, and picked up seats in suburban Ontario and the Maritime provinces. But he failed to increase his party's ten seats in Quebec. His former foreign minister, Maxime Bernier, held his seat by a landslide, surviving a kiss-and-tell book by a former girlfriend whose links to gangsters had prompted his resignation. But elsewhere in the province the separatist Bloc Québécois blocked any Conservative advance, even though independence never surfaced as an issue during the campaign.

If Mr Harper did not quite win the election outright, the Liberals certainly lost it. Their share of the popular vote fell to 26%, their lowest since the party was formed in 1867. Their leader, Stéphane Dion, a Quebecker, struggles to make himself understood in English. He chose to fight the election on a brave plan for a carbon tax just when voters began to worry about the economy rather than the environment. He seems certain to be dumped at a party convention next May. (Sadly his defeat may make other politicians think twice before championing a tax on carbon emissions.) Some of the Liberals' erstwhile supporters seem to have switched to the socialist New Democrats. Others stayed at home.

The Liberals' woes will give Mr Harper some breathing space. He will use it to fulfil his minimalist, carefully targeted promises to offer a bit more help to groups such as small businesses and disabled people. Despite his larger parliamentary contingent, he may find governing harder in his second term than his first. Canada, with solid banks and a diversified economy, has so far escaped the worst of the credit crunch. But its economy is slowing. Recession in the United States, which buys 75% of its exports, can only make things worse.

Mr Harper was due to welcome European leaders to Montreal on October 17th to launch talks on a trade agreement with the European Union. But it is the North American Free Trade Agreement (NAFTA) that really matters. To add to the economic uncertainty, Barack Obama has vowed to "renegotiate" NAFTA if he becomes the next American president in January. In practice that may amount to little more than a joint review of what is an international treaty. But to protect Canada's trade interests, Mr Harper will have to open lines of communication to the Democrats who control the American Congress. The Conservatives feel much more comfortable with the Republicans.

Mr Harper's mandate is stronger but not emphatic. Voter turnout was low. Canadians have now voted three times in little more than four years. For now they seem content to have an unambitious minority government. The opposition leaders solemnly pledged on election night to co-operate with the prime minister, but such promises are made to be broken.

Pundits predict that the new Conservative government will not last long, certainly not the 32 months of Mr Harper's first government. Its longevity depends on whether the Liberals, who have several plausible replacements for Mr Dion, revive themselves. Above all it depends on events. Already the provincial premiers have asked Mr Harper to sit down with them next week to discuss the economy. The honeymoon may be short.

Latin America's economies

Bad bets

Oct 16th 2008 | SÃO PAULO
From The Economist print edition

Currency worries in Brazil and Mexico

UNTIL the past fortnight, *a crise*, as Brazilians call it, had largely bypassed Latin America. No longer. In the week that began on October 6th the Brazilian real and the Mexican peso both plunged sickeningly (see chart), as did stockmarkets. This week saw modest recoveries. But confidence in the region's new-found stability has taken a knock.

That is because the currency movements were sudden and violent. They prompted both countries' central banks to intervene. Mexico's had to spend 10% of its reserves in just a few hours to prop up the peso. Some foreign investors began selling Latin American assets to cover losses at home. But once it started, the currency slide seemed to provoke a collective nervous twitch that led many to seek safety in the dollar. This followed years in which Mexico had worked to create confidence in the stability of the free-floating peso. "Unfortunately you cannot just unlearn a reflex developed over decades of financial crises," says Damian Fraser of UBS, an investment bank. The peso's slide was exacerbated by the unwinding of derivatives contracts that had been profitable while the currency was steady. Comercial Mexicana, a big retailer, lost $4 billion on derivatives contracts and filed for protection from creditors on October 9th.

Something similar happened in Brazil. Because Brazil's exports include a wide variety of raw materials, the real has recently come to be seen by investors as a proxy for global economic growth. When both began to fall, this triggered losses on derivatives, just as in Mexico. Grupo Votorantim, an industrial conglomerate and big exporter, used derivatives for hedging. It made profits of some 2 billion reais ($924m at the latest rate) over the past few years as the real appreciated. But earlier this month the real fell below the band specified in the contracts, triggering penalty clauses. On October 10th the company announced that it had spent 2.2 billion reais to rid itself of the troublesome contracts.

One theory is that the exchange-rate movements were so abrupt because currency dealers find it hard to raise credit, just like everyone else, and that this has cut the volume of transactions. Be that as it may, the currency turmoil will have economic effects. Until recently Brazilians worried that a rapidly strengthening real was making their exports uncompetitive. Now they have the opposite concern. Weaker currencies will mean higher inflation, because imports are more expensive.

Central bankers in both Brazil and Mexico have worked hard to establish their credibility as inflation fighters. Both have raised interest rates over the past year. Now they may have to do so again just as the gathering world recession, and the concomitant fall in commodity prices, is slowing their economies—or else abandon their inflation targets.

Until last month, most forecasters expected next year to see growth of 4.5% in Brazil and 3% in Mexico. They have since lopped about one and a half percentage points off both those figures. Even so, that points not to a bust but a slowdown. In the case of Brazil, that is healthy, since the economy cannot satisfy domestic demand (rising at 8% this year) without higher inflation, reckons Arminio Fraga, a fund manager and former central-bank president.

Even before the currency plunge, companies in both countries had started to feel the credit squeeze. Banks had stopped renewing credit lines for trade finance. Brazil's central bank has stepped in to provide financing to exporters.

Both countries have recent experience of financial panics. As a result, their banking systems are solid and quite conservatively run. And at least this time currency weakness should not have knock-on effects on public finances, nor raise fears about the ability of governments to service their debts. That is because nowadays both governments can borrow in their own currencies. The lasting question from this bout of currency instability is how long that will remain the case.

Peru's unloved president

Pursued by the ghosts of the past

Oct 16th 2008 | LIMA
From The Economist print edition

New cabinet, old problems

THE economy is heading for growth of 9% this year, the fastest rate in Latin America. Poverty, though widespread, is falling fast. Inflation reached 6.2% in September, but that is one of the lowest figures in the region. And yet for Peru's president, Alan García, matters have just gone from bad to worse. Almost halfway through his five-year term the unpopular president has been forced to replace his cabinet over a corruption scandal. The new team may find it hard to restore confidence in politics.

The scandal concerns alleged kickbacks in the award of oil-exploration contracts. Taped conversations broadcast on a television programme appeared to show that officials in the ruling APRA party received bribes in return for granting five contracts to Discover Petroleum, a small Norwegian oil company which denies any wrongdoing. The energy minister and the head of Petroperú, the state oil company, resigned, although they were not directly implicated. But that did not placate the opposition, which has a majority in Congress. Rather than face censure Jorge del Castillo, the experienced prime minister, went too.

His replacement, Yehude Simon, has had an unusual political career. A leader of a far-left party in the 1980s, he spent much of the 1990s in jail for his links with the Tupac Amaru Revolutionary Movement (MRTA), a small guerrilla group. In prison, he became a born-again Christian and political moderate. He has since twice been elected as regional governor of Lambayeque, on the north coast, where he has acquired a reputation as an effective negotiator. That may be helpful, since the main job of the prime minister in Peru is to defuse social conflicts.

Mr García is dogged by memories of his disastrous first stint in power in the 1980s. He ruled as a reckless populist, presiding over economic collapse, hyperinflation, corruption and a murderous guerrilla insurgency by the Maoist Shining Path and the smaller MRTA. He narrowly won the presidency again in 2006, partly by convincing Peruvians that he was a reformed character who believed in market economics and free trade, and partly because his challengers were even less convincing.

But despite an economic boom, Mr García's approval rating has fallen to around 20%. He is pursued by the ghosts of the past. Polls find that most Peruvians firmly believe that inflation is much higher than it in fact is. Many also believe that APRA is riddled with corruption. The involvement in the oil scandal of Rómulo León, who was accused of corruption when Mr García's agriculture minister in the 1980s, has done nothing to dispel this.

To cap it all, the Shining Path, long ago reduced to a small rump in a couple of remote drug-producing valleys, chose this month to stage its deadliest attack in years. A roadside bomb in Huancavelica, east of Lima, killed 13 soldiers and two civilians on October 9th. It appeared to be a response to an army operation to shut down Shining Path camps.

The new cabinet involves only a few changes from the old. With Mr Simon have come a couple of other moderate leftists. The finance and trade ministers keep their jobs, and economic policy is unlikely to change. Indeed finance officials plan to issue a new bond (which would reopen the market for emerging economies) to lengthen the maturity of the public debt.

But the outlook has darkened. Peru has done well from high prices for its minerals. With commodity prices falling fast, one hope for continued growth is oil and gas exploration. Congress is now reviewing all contracts awarded since 2006, and investment may slow. Peruvians have not warmed to Mr García in the good times. Unless Mr Simon can spread goodwill, the second half of his presidency looks set to be a troubled, loveless affair.

The Caribbean

Trade winds

Oct 16th 2008 | PORT OF SPAIN
From The Economist print edition

Finally, a deal with Europe

THE negotiations took almost four years but were completed last December. Ten months of dither then followed, in which arranging a signing ceremony seemed about as easy as getting a horse race under starter's orders. But finally in Barbados on October 15th, at the fifth attempt, 13 Caribbean countries approved a new Economic Partnership Agreement (EPA) with the European Union. Two more may soon join in.

The EPA involves only gradual changes to a trading relationship which goes back to colonial days. It grants almost all Caribbean exports duty-free and quota-free access to Europe. In return, the Caribbean will phase out duties on 87% of European imports by 2033. Both sides will ease restrictions on most service providers, allowing Caribbean architects or musicians to ply their trade from Vilnius to Valencia—or indeed in the French overseas *départements* of Martinique and Guadeloupe.

The Europeans hope the agreement will be the first of six with groups of former colonies in Africa, the Caribbean and Pacific. These countries have had one-way market access since 1975 under the Lomé Convention, and its successor, the Cotonou agreement. But this no longer squares with the rules of the World Trade Organisation.

The Caribbean agreement covers the Dominican Republic and Suriname as well as the English-speaking countries. Haiti, distracted by recent hurricanes, did not sign but says it will. Along with the Bahamas, it has a further six months to finalise arrangements for trade in services.

Guyana initialled the EPA in December only to have second thoughts. Bharrat Jagdeo, the president, says his country needs more aid to adjust. He has proved adept at getting outside help: the Inter-American Development Bank has spent more than $400m in Guyana in the past ten years, and the country has also benefited from debt relief worth more than $1 billion. Guyana is expected to sign shortly.

Proponents reckon the agreement will help the Caribbean to develop new exports, and to rely less on old staples like bananas and sugar. But the EPA has aroused furious opposition from an assortment of opposition parties, elderly academics, retired diplomats, churches, trade unions and NGOs. They complain that it will require higher taxes to replace lost customs revenue. Some of them worry that it covers public procurement and investment protection—issues that developing countries excluded from the stalled Doha round of world trade talks. The EPA will also require the Caribbean to extend to Europe any more generous concessions that it makes in future to countries such as Brazil or China. For such reasons African and Pacific countries have been reluctant to sign a similar deal.

Caribbean businesses seem relaxed about the loss of protection. The EPA's most prominent opponents cannot name any companies—large or small, in manufacturing or services—which oppose the deal. Many are keen to move into Europe. The region imports most of its manufactured goods anyway, and agreed earlier this year to remove duties on essential foodstuffs as a tool to fight inflation. Once the deal is signed, the politicians may start to feel better about it.

Economist.com WORLD ASIA

Asia and the crisis

Here we go again

Oct 16th 2008 | TOKYO
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The world's financial meltdown stirs uneasy memories across Asia

Illustration by David Simonds

ASIAN stockmarkets were among the most exuberant of the celebrants who briefly rejoiced at the massive financial interventions by American and European governments. In relief that global finance seemed to have survived its near-death experience, Hong Kong's equities climbed more than 10% on October 13th. Next day, Tokyo's soared a record 14%. But as elsewhere, these rallies proved an interlude in the sharp downward lurch. On October 16th Tokyo's Nikkei index slumped 11%. Relief that catastrophe seemed to have been averted was no substitute for economic confidence. A region itself buffeted by financial crisis in 1997-98 has not forgotten that economic pain long outlasts financial-market rout.

That earlier crisis started with local worries about Thailand's widening current-account deficit and a property bubble in Bangkok. It astonished the world with the speed and extent of the contagion that spread to other Asian countries, and emerging markets elsewhere, such as Russia and Brazil. This month's panic had spread even further in Asia, shaking countries that by and large sailed through the late 1990s such as India and Australia.

On October 14th Kevin Rudd, Australia's prime minister, cited "the economic equivalent of a rolling national-security crisis" and announced that his government would guarantee all deposits in Australian banks and other savings institutions for three years. He followed this with a spending stimulus worth A$10.4 billion ($7 billion), much of it directed at people likely to spend the money rather than hoard it: first-time homebuyers, the poor and pensioners. On October 14th Hong Kong issued a blanket guarantee of all bank deposits, with the aim of preventing the kind of capital flight that wrought havoc with the territory's capital markets during the 1997-98 crisis. Its monetary authority also announced a new facility for providing capital to the territory's banks, even though they look robust enough. But it was in the countries worst affected last time—Thailand, Indonesia, Malaysia, the Philippines and South Korea—that the echoes seemed most eerie.

In many ways, the region is far better placed to withstand the present shock. Its banks are stronger, its currency regimes less rigid, its foreign-exchange reserves bigger. On the other hand, a decade of accelerated globalisation has seen every country integrated even more closely into the world economy. None can hope to be immune from a global slowdown. The region may not face the sort of meltdown experienced at the end of the 1990s. But prospects for growth look much bleaker than they did even a fortnight ago. Exports to rich countries still matter, albeit less than they did. And so does trade finance, which lubricates Asia's trading machinery. Ships are sitting empty in big Asian ports, their cargoes piled

up on the dockside because no bank will guarantee them. Despite strong balance sheets, Asian banks may need more capital if they are to make up for a shortage of Western trade credit.

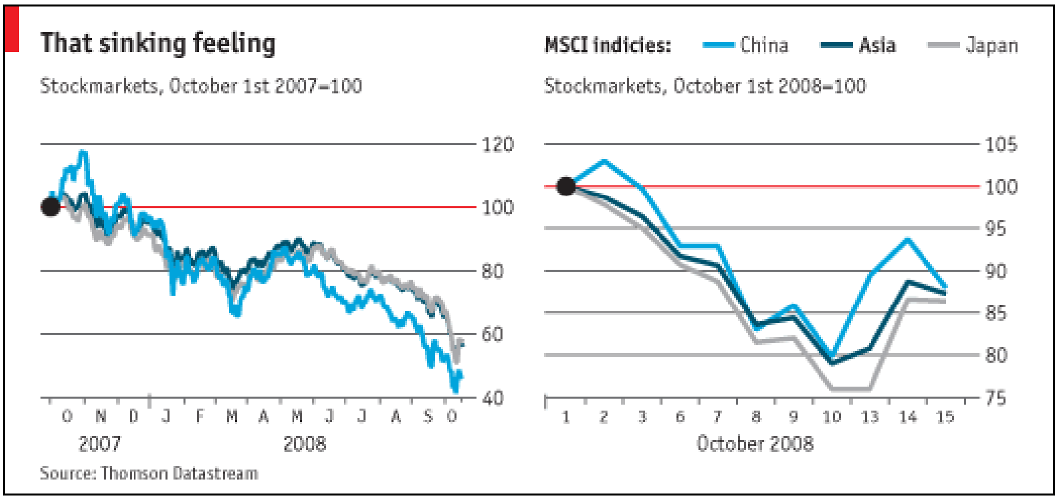
Facing such worries, anger at the apparent hypocrisy of governments in America and Europe has been muted. Asian leaders have complained that they were blamed for bringing the last crisis on themselves, with their misguided exchange-rate policies, opaque financial systems, profligate spending and corrupt politics. The bail-outs by the IMF demanded fiscal austerity at a time of economic hardship. But, since international institutions offered the only financial lifeline, most Asian governments were forced to suck up IMF orthodoxies.

True to form, Mahathir Mohamad, a former Malaysian prime minister, who was among the West's harshest critics a decade ago, has not resisted gloating. On his blog, he recalls how “the Americans” said Asian companies should have been allowed to go under, but now Americans are preparing bail-outs and nationalisation for their own firms.

China, too, which survived the last crisis fairly unscathed thanks to capital controls and a state-run banking system, has indulged in a bit of point-scoring. Its refusal to allow a faster appreciation of the yuan has been blamed by some for helping build up the huge global financial imbalances that now seem to be unwinding so fast. From China's perspective, the meltdown vindicates the cautious pace of its liberalisation. But its officials have tried not to sound too smug. Like their counterparts elsewhere in the region, they know it is too early to declare victory. Chinese journalists say the official media have been ordered to tone down or avoid reports about the economic impact on China. As during the earlier crisis China is trying to appear helpful. On October 8th it timed its latest interest-rate cut (of 0.27 percentage points) to coincide with concerted rate-cutting by other central banks. With its massive foreign-exchange reserves, China, like Japan, the other big Asian creditor nation, has too big a financial stake in the global system to feel anything other than anxiety at the possibility of an implosion.

Marking markets

So across Asia, governments have taken measures to allay disquiet (see article). In China the stockmarket has lost two-thirds of its value since last October; the property market is wobbling and growth is slowing. These trends all predated the latest panic. But the government has had to go further to shore up confidence. It tried to revive the stockmarket by abolishing a tax on share-buying and investing in the market itself. Japan, despite the giddy plunge of the stockmarket from October 8th-10th and the bankruptcy of a middling life insurer, Yamato Life, is confident that its financial system, recapitalised at massive public expense a decade ago, is robust enough to survive the latest shocks.



Japan's money markets have gummed up far less than those in America and Europe. Even so, at a time when its economy is almost certainly in recession, the authorities are taking few risks. Backed by $1 trillion of reserves, the Bank of Japan has promised unlimited dollar funds to the markets. And the government has announced measures to support regional banks. It has also promised not to sell its remaining shares in the country's biggest banks for the time being, and eased conditions for companies to own shares in each other as a way to support the stockmarket.

This year South Korea's won has sunk more than any other Asian currency. The country's current account, in surplus for many years, has slid into deficit. Banks have made a high number of loans in proportion to

their deposits. Households are deep in debt and so are many smaller companies (many in dollars). In a radio address on October 13th President Lee Myung-bak insisted that the banks were sound and pointed out that the currency was backed by far larger foreign reserves than it was a decade ago. He begged South Koreans to cut down on foreign spending and energy use, and to increase spending at home.

In India, the closeted banking system is not heavily exposed to the financial crisis. Its most adventurous bank—ICICI—is the only one so far to cause jitters. Long lionised for financial sophistication, the bank is now associated with Western financial sophistry. After its share price halved in a month, it had to send text messages to its depositors reassuring them that their money was safe. Statements of support from the Reserve Bank of India, India's central bank, and the rating agencies have helped restore confidence.

Indonesia's government intervened more drastically, halting share trading for three days after sharp falls in share prices and the rupiah. When the stockmarket reopened on October 13th, the government strengthened its guarantee of bank deposits to deter a run on banks.

Reasons for gloom

In the less panicky mood that prevailed this week, such measures appeared to have bolstered confidence. They did little, however, to ease two longer-term worries.

The first concerns countries that are embroiled in political upheaval and which may be ill-placed to cope with the economic storms to come. The second is how severe those storms are going to be.

Thailand, riven by conflict between the elected government and powerful protesters (see article) is especially vulnerable. But Malaysia, whose prime minister says he will step down, also has its political worries. In the Philippines, the latest in a series of doomed but distracting attempts to impeach the president, Gloria Macapagal Arroyo, is gathering steam.

Even if these dangers can be skirted, the region is going to experience a sharp slowdown, though perhaps only Japan and Singapore are already in recession. In China, the slowing of the economy, caused mainly by a fall in net exports, could become a serious worry in the months ahead. Most economists expect GDP growth to fall only to 8-9% next year (from 10.1% in the second quarter of this year and 12.6% a year earlier)—hardly a grinding halt. Most Chinese economists are confident that if the slowdown is sharper, the government can still spend its way out of trouble. But an article last month in a magazine published by a government think-tank warned that a severe slowdown could present China with the kind of social turbulence that ravaged Indonesia in 1998.

China's growth is increasingly important for the region. This month Australia 's Mr Rudd rang the Chinese prime minister, Wen Jiabao, to ask about projections for China's growth, and whether its strong demand for Australia's minerals was likely to continue. On getting an upbeat answer, Mr Rudd concluded that China was now "critical for Australia's continued economic performance". It is also the biggest trading partner for Japan and India. But, according to the Asian Development Bank, 60% of Asia's exports (not including Japan's) still go to America, the European Union and Japan. A decline of one percentage point in America's growth rate, the bank calculates, knocks 0.3 percentage points off Asia's. That may be optimistic.

To date, one constant since the 1997-98 crisis has been the absence of a co-ordinated regional response. Out of that crisis, a self-help initiative among the region's central banks known as the "Chiang Mai initiative" was launched. But it seems designed to fight the last war—a concerted attack on a country's currency—rather than today's wider financial malaise.

Coincidentally, Asia's leaders will be meeting counterparts from Europe in Beijing on October 24th for the biennial "Asia-Europe" meeting, ASEM. The Philippines' Mrs Arroyo has in vain suggested holding a crisis summit of the Asian countries on its margins. She also boasted this week of an agreement to set up a fund to buy toxic debts from banks in South-East Asia, China, South Korea and Japan. But the World Bank, the alleged source of some of the money, and the other countries involved, could not recall such an agreement. So she managed only to heighten the impression of ill-co-ordinated floundering. At least China, the host of the ASEM talk-shop, has overcome its initial reluctance to put impending financial collapse on the agenda. It seems to have realised that it would seem odd indeed if Asian leaders spent much time talking about anything else.

North Korea

Terror off track

Oct 16th 2008 | TOKYO
From The Economist print edition

George Bush kicks a nuclear can down the road

AP

High summer for Kim

IT'S official: North Korea's regime may be brutal in all sorts of ways, but it no longer sponsors terrorism. On October 11th the United States removed the country from its terrorism blacklist, two decades after two North Korean agents blew up a South Korean airliner and killed 115 people—apparently on the orders of the North's current ruler, Kim Jong Il.

With his presidency a lame duck, George Bush counts this as a rare foreign-policy success. North Korea had long wanted to be scrubbed from the list. Indeed, as part of the "six-party process" meant to wean North Korea from its nuclear ambitions, Mr Bush had promised it would happen as soon as Mr Kim provided full details of his nuclear programmes and consented to a proper means of verifying that they were indeed being dismantled.

In June North Korea handed over sheaves of documents. Mr Bush set the business of delisting in train. But then things stalled as North Korea proved less than frank about its programmes. These may include spreading nuclear technology in the Middle East and suspected uranium enrichment—on top of the plutonium programmes that produced the nuclear device which North Korea exploded in October 2006. When the Bush administration started humming and hawing, the government in Pyongyang threw a fit. It barred inspectors from the Yongbyon nuclear facility that it had closed and begun dismantling. It then threatened to start reprocessing plutonium there, putting the six-party talks in jeopardy. The delisting is the price for keeping things on track, at least partially.

The Americans had demanded a verification regime that allowed inspectors to roam at will. Compared with that, the agreement reached in Pyongyang by Christopher Hill, an assistant secretary of state, is vague indeed: part of it has been reached only verbally. Inspectors will be allowed back to sites that North Korea has officially admitted to. So they swiftly returned to Yongbyon. But in a country with countless underground facilities, other sites may be visited only by "mutual consent".

As well as coming off America's blacklist, North Korea now gets more shipments of heavy oil and other aid from the United States, China, South Korea and Russia. The sixth member of the talks, Japan, will not provide aid until North Korea is more forthcoming about Japanese nationals who were kidnapped in the 1970s and 1980s. It is not happy about Mr Bush's latest move, but, says Shotaro Yachi, who recently retired as Japan's senior diplomat, it hardly does to show North Korea a divided front. Japan's complaints are muted.

Condoleezza Rice, America's secretary of state, describes the delisting as a "formality"; many sanctions remain in place. It keeps the six-party talks going until the next administration, which must deal with the tricky details of verification. Many North-Korea watchers are sure Mr Kim has no intention of giving up nuclear weapons. But perhaps the talks can be kept alive longer than Mr Kim. His health is the subject of intense if uninformed speculation. The government has just released new photographs of the Dear Leader, apparently in good health (see picture above). But are they really new? Anonymous leaks from South Korean and American intelligence agencies display a genius for botanical analysis: the green of the foliage, they say, looks more like high summer than autumn.

Land reform in China

Promises, promises

Oct 16th 2008 | TIANJIN
From The Economist print edition

A “breakthrough” in land reform? Or a damp squib?

AP

Collective ownership, singular toil

THE farmers of Shangmatai township, about 90km (55 miles) south-east of Beijing, near the port city of Tianjin, are waiting anxiously for land reform. According to the peasants, the local government has seized their land to build an artificial lake in order to attract tourists. They say they have received no compensation. Late last year lawyers and academics in Beijing seized on their dispute with officials, among several others, as a reason why peasants should be given clearer ownership rights. “Peasants want to recover the land ownership rights that belong to us,” says a statement signed by 17 farmers of Shangmatai in March.

So far, they have had no luck. Activists say they are kept under surveillance. Several claim to have been beaten by goons hired by local officials. One was detained for 18 days in April. Courts have refused to hear their case and officials have tried to intimidate a lawyer representing them, the activists say.

Their main hope now appears to rest with the Communist party’s leadership. After a meeting in Beijing, the party has announced “breakthroughs” in its thinking about the countryside. A communiqué issued on October 12th by the party’s Central Committee promises “a new upsurge” in rural reform. Some believe that, at long last, the party has recognised that the key to agricultural improvement is land ownership. But such is the secretive way that policymaking works in China that it may be several days (or longer) before news trickles out of what these “breakthroughs” actually amount to. The details, for the time being, are classified.

At the moment, rural land is “collectively” owned but may be leased to peasants on 30-year contracts. It cannot be mortgaged and selling usage rights or buildings can be legally problematic. Urban land, in contrast, though state-owned, is readily traded, with far longer leases.

Chinese academics have long argued that a freer and better-regulated rural property market is essential if peasants are to enjoy more of the fruits of growth. They say it would encourage the consolidation of tiny, inefficient plots of land leased to farmers by collectives and allow peasants to cash in on their land’s market value, enabling them to use the capital to go into business in the cities. Academics also think that a proper land market would protect farmers from indiscriminate land grabs by local officials who often take collective ownership to mean control by themselves.

Of the tens of thousands of peasant protests that occur every year in China, nearly half relate to land grabs, said a report in *Caijing*, an influential Beijing magazine. Tighter approval procedures introduced in 2006 have simply resulted in local officials forcing peasants to rent their land, instead of seizing it outright. This problem, the report said, was getting “worse and worse”.

This is all the more embarrassing because of the party's plans to celebrate the 30th anniversary of China's economic reforms in December. Rural residents are much better off than they were in 1978, especially thanks to the growth of non-farming incomes. But city-dwellers have grown richer even more quickly. Migrants from the countryside to the cities are still largely excluded from urban social-security provisions as well as the subsidised education that city-dwellers enjoy.

President Hu Jintao appeared to signal a new approach by paying a visit in September to Xiaogang village in the central province of Anhui. Xiaogang has an almost totemic significance. Peasants there met secretly 30 years ago and agreed to parcel out communal land to individual households. The party has long hailed this action as the beginning of the end of the disastrous Maoist agricultural system. Optimists thought that by going to Xiaogang, Mr Hu was hinting that something similarly big is once again afoot.

But for all the official hype about the Central Committee recent meeting—of "great, profound and far-reaching significance", said the *People's Daily*—the party remains weighed down by taboos. Two years ago it decreed that 120m hectares must be preserved as arable land to ensure food security. That leaves hardly any for conversion to other uses.

Since the meeting, the Chinese media have reported that the basic principle of collective ownership of rural land will remain unchanged. This means village committees, mostly controlled by party appointees, will surely retain considerable say over any land deals. Some reports have said reforms could start with free trade in non-arable rural land. Guangdong Province in the south has partially allowed this since 2005. But officials in Beijing still worry that the practice could result in swathes of farmland being redesignated as non-arable in order to open it up for sale.

One specific idea the Central Committee has announced is that peasant incomes are to be doubled by 2020. But even this is cautious. It requires an annual growth rate of 6%, about what China expects to achieve this year but down on last year's 9.5% and less than the 7.1% average since the reforms began. The party's prescription could amount to more of the same.

Thailand

Fuelling the pyre

Oct 16th 2008 | BANGKOK
From The Economist print edition

The anti-government mob claims royal backing

CLAD in black and attended by a clutch of photographers, Queen Sirikit and a daughter, Princess Chulabhorn, led the cremation ceremony on October 13th of Angkhana Radappanyawut, who died in violent clashes in Bangkok six days earlier. Ms Angkhana had been supporting the anti-government People's Alliance for Democracy (PAD) in its attempt to blockade parliament. Her family said the queen had told them she was a "good girl" and a "protector of the monarchy and the country".

The PAD, which has occupied government offices since August, says it is defending the crown against the supposed republicanism of Thaksin Shinawatra, the prime minister who was deposed in a coup in 2006 but whose allies returned to power after an election last December. By provoking violence the PAD hopes to trigger another coup.

Neither the queen nor other royals had attended the funeral of a pro-Thaksin protester killed in earlier clashes, in September. After the latest violence, the queen criticised the police's use of tear-gas and paid the medical bills of injured PAD protesters. Only after the PAD trumpeted this as royal endorsement for their cause was it announced that the queen would also subsidise the treatment of policemen who had been injured.

It is hard to be sure what the relationship between royalty and the protesters really is. Another princess, Sirindhorn, was asked during a visit to America if she agreed with the PAD's claim to be defending the monarchy. According to the Associated Press, she replied "I don't think so…they do things for themselves". Her father, King Bhumibol, has remained silent.

It is also unclear how much of the reverence that the king himself enjoys also extends to other royals, since all discussion of such matters is forbidden by a harsh *lèse-majesté* law. There will be many whispered private conversations about whether the queen's intervention is helpful in healing the deep divide that splits the government and opposition, and about where the various royals may stand on the issue. But no public debate.

The PAD hopes a royal imprimatur will foster the idea that "Black October" was all about police brutality. A forensic scientist, Porntip Rojanasunan, said some police used dodgy Chinese-made tear-gas canisters that explode on impact. Dr Porntip said the wound on Ms Angkhana's body could have been caused by such an impact but she was not yet sure. However, the PAD's leaders knowingly sent their protesters to clash with police they knew were poorly trained and equipped. Some protesters attacked police with handguns, sharpened spikes and home-made bombs fashioned from ping-pong balls.

The pro-Thaksin United Front for Democracy Against Dictatorship held a 10,000-strong rally two days before Ms Angkhana's cremation. Like the PAD it is arming and training "security guards". Both groups have democracy in their names but are mainly led by reactionaries, unconcerned how many pawns die fighting their battles. Another coup or fresh elections, the two solutions most widely touted, may only postpone the next clashes. Making things worse, a border spat with Cambodia, whipped up by the PAD, this week led to both sides' troops firing on each other. The only person with the authority to plead for sanity is the king. Thailand is waiting.

Afghanistan

A surge of pessimism

Oct 16th 2008
From The Economist print edition

America worries about Taliban advances and British despondency

AFP

Looking for the exit?

THE Taliban have been brave and brazen this fighting season. They have used more "asymmetric" tactics, such as suicide bombings, but have not shied away from direct combat. In July, they tried to overrun a new American outpost in Nuristan province, killing nine Americans. In August, they attempted to fight their way into a big American base outside Khost, a town that for a year had been a model of stability. Earlier this month they made a three-pronged stab at Lashkar Gah, the capital of Helmand province.

All these attacks were repelled. But despite heavy losses for the insurgents, they sent a powerful message: the Taliban are getting stronger and areas once deemed safe are under threat. Provinces around Kabul are more violent and roads leading out of the capital are frequently cut off. Though there are fewer bomb attacks than a year ago, the capital feels besieged, prompting some to recall the days when the anti-Communist mujahideen moved to take over the city in 1992, and again when the Taliban rode in four years later.

This is much too gloomy. America shows no sign of giving up as the Soviet Union did in 1989; indeed, both American presidential candidates have pledged to reinforce the military operation. Still, Admiral Mike Mullen, America's most senior officer, makes no secret that Afghanistan is "not going in the right direction".

In its dying days, the Bush administration has begun a wholesale reassessment of its mission in Afghanistan. The Americans worry not just about the Taliban, but also about their own NATO allies, particularly Britain. Two reported sets of comments by senior British figures—the ambassador to Kabul, Sherard Cowper-Coles, and the recently-departed British military commander, Brigadier Mark Carleton-Smith—have raised concern that the British are tiring of the fight.

In remarks to a French diplomat—whose cable was then leaked to a satirical weekly, *Le Canard Enchaîné*—Sir Sherard is reported to have said that America's strategy was doomed, and that presidential candidates had to be persuaded not to get further bogged down. Foreign forces were part of the problem, not the solution; a surge of troops would merely increase Afghans' sense of occupation. The only solution was an "acceptable dictator". A few days later Brigadier Carleton-Smith, the commander in Helmand province, was quoted as saying, "We are not going to win this war". Rather, military operations were about reducing the insurgency to a size that Afghan forces could handle. The idea of negotiating a political settlement with the Taliban, he said, "shouldn't make people uncomfortable".

Both men claim to have been misrepresented. Moreover, American commanders say similar-sounding things: no purely military solution is possible; a political dialogue is vital. But perception and nuance

matter. There is a difference between saying there is no military solution and believing the mission is bound to fail; between trying to draw individual commanders away from the Taliban and sharing power with their leader, Mullah Omar.

Those in Washington who watched the British in Iraq leaving Basra's city centre just as the Americans were surging into Baghdad in 2007—and saw how British soldiers stood aside while American and Iraqi troops were clearing Shia militias out of Basra earlier this year—worry that the British are becoming defeatist. Certainly the Taliban present Western doubts as evidence of their impending victory. A recent statement says: "The only solution and the most successful path for resolving the Afghanistan problem is for the foreign forces to leave Afghanistan unconditionally."

Britain's position is important not just because it makes the second-largest military contribution in Afghanistan, but because a British loss of will could prompt other allies to rush for the exit. The Dutch are already expected to stop fighting next year and the Canadians could leave in 2011. Robert Gates, America's defence secretary, says extra American troops being sent to Afghanistan—an additional brigade in January and possibly two or three more later in the year—should be seen as reinforcements, not replacements. In reality, though, the NATO venture is becoming ever more Americanised.

Along with a surge of foreign forces, there needs to be a surge of Afghan ones. The Afghan army is being expanded, and a rudimentary air force is being built. But the new ceiling of 122,000 men is far short of the nearly 260,000 soldiers in Iraq, a country smaller in size and population than Afghanistan. There are about 80,000 Afghan policemen, many of them seen as bandits, compared with about 250,000 Iraqi ones. In addition, in Iraq the Americans set up 100,000-strong tribal militias that were instrumental in evicting al-Qaeda from large parts of the country.

Perhaps the most important element of any new strategy is one the United Nations envoy, Kai Eide, calls a "political surge" to boost the Afghan government. It is the most difficult to achieve. President Hamid Karzai, once regarded as a saviour of the country, is increasingly seen as ineffective. Diplomats say President George Bush has treated him uncritically. A report in the *New York Times* about American suspicions concerning alleged drug connections of the president's half-brother, Ahmed Wali (which he denies), may be a sign that Washington's patience is running out. Not certain, however, is whether a credible alternative leader can emerge—and whether, faced with a stronger Taliban, a new American president would ever dare engineer Mr Karzai's replacement.

Israel

Settlers against a settlement

Oct 16th 2008 | JERUSALEM
From The Economist print edition

If Tzipi Livni becomes prime minister, as looks increasingly likely, one of her biggest challenges will be to face down Jewish settlers on the West Bank

Flash 90

THE policy proclaimed by young Jewish settler-militants on the West Bank is called “Price Tag”. Whenever the Israeli army tries to dismantle settler outposts—even individual caravans or huts—that have not been authorised by the Israeli authorities, the militants retaliate violently. Not necessarily in the same place; they may hit Palestinians or soldiers somewhere else. They stone cars, smash windows, burn olive trees and fields. They attack villagers and shepherds, and tangle with the army and police.

Their aim is to persuade Israelis that no further forcible dismantlement of Jewish settlements is possible. When Ariel Sharon was prime minister, he did it once, in 2005, in the Gaza Strip and northern bits of the West Bank, evacuating 21 settlements, against little hard resistance. When Ehud Olmert, who succeeded him, demolished nine buildings at Amona, in 2006, thousands resisted. Now passive resistance is bolstered by physical retaliation.

The militant core group once numbered dozens, says the Israeli general commanding the West Bank, Gadi Shamni. Now there are hundreds. And they are backed, he says, by rabbis and political leaders from the more mainstream settler movement. The general sounds powerless, as he gives warning that “the extremist margins are growing wider.” The settlers have been running rings round the army for decades. That is how many of the settlements and outposts got built in the first place, defying the government’s purported restrictions.

Now a new government under Tzipi Livni, hitherto the foreign minister, looks likely to take over. Will she stiffen General Shamni’s spine? For decades the Israeli establishment has been flaccid in the face of the settlers. But she has a chance to build on the changing thinking of her three predecessors. Ehud Barak (1999-2001) accepted the principle of swapping territory and sharing Jerusalem; Ariel Sharon (2001-06), actually evicted several thousand settlers; and Ehud Olmert (2006-08) now says that the land swaps must be equal, so that the Palestinian state ends up with the full equivalent of territory occupied by Israel in the war of 1967.

Ms Livni also knows that her Palestinian negotiating partners accept swapping land and sharing Jerusalem as the basis in principle for a border deal. She herself has been talking for months to Ahmed Qurei (also known as Abu Alaa), the Palestinian Authority’s chief negotiator, while Mr Olmert has held parallel talks with the Palestinian president, Mahmoud Abbas.

But for all his talk of an equitable partition, Mr Olmert presided over a period of settlement expansion. Even since he pledged at a peace conference in Annapolis last November to stop settlement building, more than 2,000 new homes have gone up. As defence minister responsible for policy in the occupied territories, Mr Barak will keep his job under Ms Livni.

As prime minister, Mr Barak did nothing while the settlers built with single-minded vigour. Do not, he argued, waste political energy and military muscle on removing the odd settlement when soon there will be a comprehensive agreement with the Palestinians. This, he and President Clinton proposed and Yasser Arafat rejected, would let Israel keep the densely populated settlement "blocks" abutting the old border (see map) and compensate the Palestinians with land elsewhere.

Mr Sharon drove Mr Barak from office but in time he accepted his thinking. The barrier on the West Bank, which Mr Sharon at first opposed but later espoused and energetically began to build, dovetailed with this long-term strategy of distinguishing between the big blocks and the more scattered, remote and smaller settlements.

The nub of the territorial dispute has narrowed down to the blocks' size. Under Mr Sharon, the barrier was several times pushed back towards the old 1967 border by Israel's High Court after appeals by Palestinians whose lives were made miserable by it. George Bush's administration, which made periodic but mealy-mouthed complaints to Mr Sharon and then Mr Olmert about settlement-building, objected more vigorously to Israel's fencing in the more salient of the blocks, at Ariel and Maale Adumim, which is why the barrier round these areas is incomplete.

Israel says the barrier is temporary and reversible (it is 95% fence, 5% concrete wall), conceived at the height of the second Palestinian *intifada*, or uprising, that started in 2000, and says it has plainly succeeded in stopping suicide-bombers crossing into Israel proper. If completed as planned, it would encompass some 8% of the West Bank. Palestinian negotiators envisage a swap of no more than 2% or

so. Another awkward complication is that Israel suggests that the Palestinians annex land adjacent to the Gaza Strip. But Gaza is ruled by the Islamist movement, Hamas, which on principle opposes a negotiated peace based on two states existing side by side.

The settlers are a big impediment too. The hard-core “ideological” ones, most of them religious, have never accepted the logic of the blocks and still seek to prevent a viable, contiguous Palestinian state by cutting into its territory with their settlements and web of linking roads. Most of the 100-odd “unauthorised” outposts are east of the planned barrier. Peace Now, an Israeli group that monitors settlement building, says that 493 new housing units have gone up east of the planned barrier in the past year, in outposts and older settlements. Most of these are caravans and prefabs, some smuggled in piecemeal past the army’s check-points. They represent 18% of all settlement building in this period, but the amount of land they have taken is a much higher proportion, says Peace Now.

The settlement leaders seem pleased. They say the accretion of young families and single people into outlying communities means the movement was not broken by Mr Sharon in Gaza. They reject the idea, embraced by most Israelis, that almost all the West Bank will have to be given back.

Nominally, Israel accepts that it must stop all settlement building on both sides of the barrier and in East Jerusalem. But Mr Olmert never countenanced limits to new building in the new Jewish suburbs of East Jerusalem, where 180,000 Jews now live; he never shrank from saying so, even though he now favours dividing sovereignty in the city between the Jewish and the Palestinian areas as part of a peace deal. Some 2,400 new homes were begun in these Jewish suburbs during his two-and-a-half years in office. As for the big settlement blocks, he was more circumspect in public but hardly so in his actual policy. By one count, the settler population rose by 50,000 during his term.

Counting settlers is a matter of terminology as well as of numbers. Many of the 275,000 settlers (in the midst of roughly 2.2m West Bank Palestinians, by Palestinian estimates) do not feel like settlers and do not identify themselves with the movement. Their settlements are so big and long established that many of their occupants, especially younger ones, are barely conscious of living on the occupied West Bank. This is especially true of ultra-Orthodox communities close to the 1967 border such as Beitar Ilit and Modi’in Ilit. It is also true of Maale Adumim and Ariel, mainly secular towns offering cheaper housing.

The original settler ideologues dreamt of a future in which hundreds of thousands of Israelis would live in the “newly liberated” areas. But they have been only partially successful, since the vast majority—perhaps all but 70,000 or so settlers—live in the blocks. So those seeking a two-state solution still hope for a division of land between the two nations. Mr Olmert talked the talk. It will be Ms Livni’s biggest challenge to turn talk into action.

Congo and Rwanda

Old foes, new threats

Oct 16th 2008 | KINSHASA
From The Economist print edition

Fears of another war between two long-time enemies are growing

FIVE years after the official end of a devastating war and two years after successful elections run by the United Nations, Congo is again falling into violence. Fighting between the army and a resurgent bunch of militias is rapidly engulfing the country's previously pacified eastern Ituri district. Uganda's Lord's Resistance Army is again active along the northern border with Sudan, slaughtering hundreds of civilians and kidnapping hundreds more children last month. And smouldering violence between Tutsi rebels and Congo's army has erupted into full-scale war in troubled North Kivu, since the collapse of January's peace deal that was meant to end more than a decade of violence there.

Moreover, as bad as things are, they soon could get a lot worse. "We fear that huge, frightening massacres could start again in the eastern area and in Kivu," France's foreign minister, Bernard Kouchner, recently said. In particular, the insults being swapped by the rulers of Congo and those of its neighbour and erstwhile enemy, Rwanda, are ominous. After an army base in North Kivu was attacked earlier this month, Congo accused Rwanda of sending troops over the border to abet the North Kivu insurgents, led by a renegade Tutsi general, Laurent Nkunda. Diplomats are scrambling to avoid another regional war.

Though General Nkunda's rebels are at the core of the fighting, the root of eastern Congo's woes is another armed group, the Democratic Forces for the Liberation of Rwanda (FDLR), composed in part of former Rwandan soldiers and Hutu extremists responsible for orchestrating the genocide of 800,000-plus people in Rwanda, mainly Tutsis, in 1994.

Rwanda's Tutsi-led army has twice invaded Congo under the pretext of squashing the FDLR. Last year Congo agreed, yet again, to rid sensitive border areas of the FDLR. In fact, Congo has done little to force it to lay down its arms. Credible reports support Rwanda's accusations that the Congolese army colludes with the FDLR, notably over control of North Kivu's lucrative mineral trade.

In truth, Rwanda's president, Paul Kagame, may be less keen than he says he is to have the FDLR disarmed and sent home to Rwanda. Gregory Mthembu-Salter of the South African Institute for International Affairs says, "Rwanda refuses the FDLR's demand to return and transform itself into a political party and contest elections [in Rwanda]. If Rwandans don't want to do that, then it seems the status quo works OK for them."

Rwanda's government has refused to negotiate directly with the FDLR. European Union and American mediators, Mr Kagame's staunch allies, have done nothing to press it to do so. The UN and other governments backed the January peace deal in North Kivu that addressed Mr Nkunda's rebellion but offered no forum for talks with the FDLR. Since that agreement failed, violence has forced more than 100,000 people to flee their homes since mid-August.

Earlier this month, with his 17,000-strong mission ever more unable to cope, the head of the UN in Congo appealed to his bosses for more troops to "surge" into the north-east to end the violence once and for all. Thousands of troops have in fact been earmarked for Darfur, in Sudan, but have yet to arrive there. If Rwanda does invade Congo again, UN troops will be unable to do much about it.

Mauritius

Beyond beaches and palm trees

Oct 16th 2008 | PORT LOUIS
From The Economist print edition

An isolated island continues to reinvent itself and confound the sceptics

THE 1.3m people of Mauritius love to prove famous people wrong. On independence from Britain in 1968, pundits such as a Nobel prize-winning economist, James Meade, and a novelist, V.S. Naipaul, did not give much of a chance to this tiny, isolated Indian Ocean island 1,800km (1,100 miles) off the coast of east Africa. Its people depended on a sugar economy and enjoyed a GDP per person of only $200. Yet the island now boasts a GDP per person of $7,000, and very few of its people live in absolute poverty. It once again ranks first in the latest annual Mo Ibrahim index, which measures governance in Africa. And it bagged 24th spot in the World Bank's global ranking for ease of doing business—the only African country in the top 30, ahead of countries such as Germany and France. How does it pull it off?

The country has come a long way from relying exclusively on sugar cane. It has become a popular destination for tourists craving sun, palm trees and good service, with more than 100 hotels, up from a single decent one at independence. Since then it has built a textile industry on the back of preferential market access. Although there were plenty of sceptics when it tried to become an offshore financial centre, the island now hosts 19 banks, including foreign heavyweights such as HSBC; and the introduction of Islamic banking has brought petro-dollars from the Gulf. Thanks to some helpful double-taxation treaties, Mauritius became a low-tax gateway for investment into other countries, especially India.

That rosy outlook might have darkened in 2005 with the end of the Multi-Fibre Arrangement that had restricted Chinese textile exports. As Mauritian factories closed, about 30,000 jobs were lost. Europe also started dismantling the sugar preferences it granted to its former colonies, which used to guarantee above-market prices. Local farmers were squeezed.

Instead of moaning, Mauritius's government moved swiftly to embrace global competition. It simplified and cut taxes, slashed red tape and lowered or dropped tariffs. The government tightened its purse-strings. Last month it brought in a new labour law, making it easier to hire and fire. The authorities and the private sector, working hand-in-hand for years, promote Mauritius as a business destination.

This has paid off. Unemployment is down, from 9.6% in 2005 to 7.6%. So is the budget deficit. Raju Jadoo, the dynamic head of the Board of Investment, says that more foreign money has been invested in Mauritius in the past three years than in the previous two decades. Long a gateway for investment into Asia, Mauritius now promotes itself as a stable jumping-board for investment into Africa. The government has persuaded China to select Mauritius as one of the five African destinations—and the only one with no oil or minerals on offer—where special investment zones will be set up. The Chinese will spend about $700m to build offices and factories north of the capital, Port Louis, for their companies keen to export to Africa.

Not everything is positive. Mauritius imports most of its food and energy, so rising world prices are pushing up inflation. Much of the economy remains concentrated in the hands of a few local conglomerates, often owned by descendants of French settlers who made their original fortunes out of sugar. The government has promised to spread the benefits of a growing economy more widely, but the so-called "sugar barons" still wield much influence. The imminent creation of a competition commission, together with the development of new industries, may help loosen their grip.

A recession in rich countries will hit the country's tourism and exports. But Mauritius has weathered previous storms. Its prime minister, Navinchandra Ramgoolam, says its success has depended on regular changes of government at the ballot box. An independent judiciary helps, as does the fact that the three main parties all agree on the broad direction of policy.

The island's people are a mix of Indian, European, African and Chinese. Religious, ethnic and cultural

differences run deep. But Mr Ramgoolam says the island has avoided the “poison of communal divisions”. The fact that Mauritians were all immigrants also helps; some were colonials, many were indentured labourers. “All of us came on different ships from different continents,” says the prime minister. “Now we’re all on the same boat.”

Nigeria

History on horseback

Oct 16th 2008 | KANO
From The Economist print edition

Why the northern durbars still matter

SHADED from the fierce sun atop a battle-dressed horse and protected by bodyguards in red and green tunics, the emir of Kano looks on serenely as wave upon wave of horsed warriors, spears and swords aloft, charge down on him, only to peel off and acclaim him at the last moment. It is the sunset climax of Kano's durbar, a gaudy show of power and tradition that locals say is unrivalled in west Africa in scale and pomp.

During the day, the city's normally traffic-choked streets are taken over by thousands of medieval horsemen: soldiers, princes, hunters, musicians and their liege, the emir. Dressed in embroidered robes and wearing elaborately tied turbans indicating lineage, the horsemen make a fearsome sight, giving off a heady waft of horse, mothballs and sweat.

Young boys in scruffy T-shirts watch from tree tops as the sons of the elite parade by. The most privileged proudly sport two horns that jut from their ceremonial turban, indicating a direct blood link with the emir.

When the British rulers arrived in the 19th century, a string of Muslim emirs controlled warrior kingdoms across the territory of today's northern Nigeria. The emirs were the political and religious rulers, holding a rare dual power. Now political power is vested in the elected governor of Kano state, but the emir still commands great moral authority.

Abba Bashir Yola is an aide to the emir. With a sky-blue turban covering head and chin, plus matching cream and blue robes, he says the durbar avows Kano's religion and heritage: "The significance of this one is to unite our people, to rejoice together, and to give thanks to God." In northern Nigeria, as in India, the durbars were created by the British as a means of taming war-related activities and turning them into ceremonial events. "The durbar is the totality of our experience of life, the totality of our culture," says Yusuf Maitama-Sule, a writer and former minister.

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Europe and the financial crisis

The end of the beginning?

Oct 16th 2008 | BERLIN, MADRID, PARIS AND ROME
From The Economist print edition

The promise of huge bank bail-outs only briefly calmed financial markets, as worries then shifted towards the risk of a deep recession

AFP

ONLY a genuine crisis could have prompted such a role reversal: a British prime minister, “the magician of Anglo-Saxon social-liberalism” as *Le Monde* called him, giving lessons on market intervention to his European colleagues. Even France’s president, Nicolas Sarkozy, who had invited Britain’s Gordon Brown to an emergency summit of euro-area countries on October 12th, hailed the outcome as the start of a new era, adding that “the time of every man for himself is over.”

Europe’s leaders duly agreed to follow Mr Brown’s example, putting up huge sums of money and standing ready to recapitalise and take equity stakes in their banks (see article). A staggering total of some €1,873 billion ($2,556 billion) was agreed for this purpose in the euro area alone. And unlike the previous week, stockmarkets were momentarily impressed. On October 13th and 14th they rose strongly, only to fall back sharply later in the week as fears of recession grew.

France has pledged €320 billion in state-guaranteed lending to banks, and €40 billion to recapitalise banks in trouble. The lending comes with conditions, including over bosses’ pay. For now, there are few demands for help. The British may be partly nationalising three of their biggest banks; the French have bailed out just one, Dexia, a small Franco-Belgian lender.

In truth, the bail-out fund is intended as a precautionary, confidence-boosting measure. Thanks to their wide retail networks, and relatively tight regulation, most French banks have been able to absorb the huge losses they have made on subprime loans in America. Nor have the French been on a huge credit binge. The household savings rate remains high.

Yet worries are growing about the economy. Third-quarter GDP figures are likely to show that the French economy is already in recession. The IMF forecasts growth of just 0.2% in 2009; plenty of economists expect an outright contraction. Unemployment has begun to climb. Renault, a carmaker, recently announced 4,000 job cuts in France.

Germany’s rescue package includes a state guarantee worth €400 billion to back banks’ loans to each other, plus €80 billion to top up capital. As elsewhere no “system-relevant” bank will be allowed to fail; no depositor will lose money. At the end of 2009 the life support will be switched off and the free market is meant to be back in business again.

German shares briefly surged after the unveiling of the rescue deal. The head of Germany's banking association said that it signalled "the turnaround". Ordinary politics was put aside. After early wobbles Germany's top crisis managers, the chancellor, Angela Merkel, and the finance minister, Peer Steinbrück, appeared to regain their footing, joining in the European bail-out having previously rejected the idea of a common fund.

Yet the mood in Germany remains jittery. The government is struggling to explain to voters how half a trillion euros—nearly double the federal budget—can be available for bankers but not for pensions or schools. It hopes the strings attached will help. Banks will pay fees for the guarantees. If the state tops up capital they must stop paying dividends and cut salaries and bonuses. Those that use the lifeline should not earn more than €500,000 a year, said Mr Steinbrück.

Even if the bail-out works, Germany will not avoid a slowdown. The IMF expects no growth at all next year. In a forecast on October 14th, the five main economic institutes predicted growth of just 0.2%. Germany has sounder public finances, less indebted enterprises and more competitive wages than others. Yet it is more dependent on exports, so will be hit harder by a global slowdown.

Club Med blues

In January **Italy** takes over the G8 presidency, and will have a chance to shape reform of the world financial system. Giulio Tremonti, Italy's finance minister and author of a book sharply critical of the present arrangements, wants radical reform, with a broadened G8 and new roles for the IMF and World Bank. He also wants discussion on abolishing hedge funds, which he says are "absolutely crazy" and "nothing to do with capitalism".

Yet both he and his prime minister, Silvio Berlusconi, exude confidence that Italy's banks are healthy. "The soundest in Europe", Mr Berlusconi has called them. As Mr Tremonti admitted to parliament, this is partly because Italian banks are "less advanced and sophisticated" than others in Europe. So far, only the enterprising UniCredit has suffered, largely because of its exposure in Germany where in 2005 it bought HypoVereinsbank.

The government has belatedly begun to equip itself with legislation to allow it to intervene in the banks. But Italy is alone among the big European countries in having neither a bank rescue fund nor a figure for the sum it is ready to make available. Mr Tremonti has merely said he would spend "as much as necessary".

Tito Boeri, an economics professor at Milan's Bocconi University, applauds Mr Tremonti's measured response to the banking crisis, but worries that "he is not fully aware of the effect on the real economy." The government is still forecasting GDP growth of 0.5% in 2009 and Mr Berlusconi said this week the economy was "certainly not in recession". But this is now a minority view. The employers' federation, Confindustria, expects the economy to shrink by 0.2% this year and 0.5% next.

Spain's prime minister, José Luis Rodríguez Zapatero, is one of the few European leaders still smiling. His country's banks lack liquidity but none has needed rescuing. Indeed, Banco Santander, now Europe's biggest bank, has gone on a buying spree of failing banks in Britain and America. In today's topsy-turvy world, Socialist-led Spain seems one of the least interventionist countries in Europe.

Yet Mr Zapatero has little reason to feel smug. If banks have survived, it is thanks to the Bank of Spain's tight regulation and to the prudence of Spanish bankers. Some savings banks still look vulnerable. And on the economic front, Spain is worse off than many others. The financial crisis is hitting an already wounded economy. A burst housing bubble has punctured Spain's growth. Recession is around the corner. The IMF expects the economy to shrink by 0.2% next year. The unemployment claimant count stormed to an 11-year-high in September. "Spain's economy will be in a worse situation in a year's time than other European economies," concludes José Luis Martínez, a strategist at Citibank.

The cost of the bank bail-outs and the coming recession also raise questions about governments' fiscal positions. Ireland this week became the first euro-area member to declare that it would bust the stability-pact ceiling on budget deficits of 3% of GDP next year: it expects a deficit closer to 6%. France and Italy, which has the euro area's biggest debt burden, are also close to the limit. Even in Germany and Spain budget deficits are likely to climb. The markets are starting to reassess individual countries: the spread on Italian over German government debt has widened to some 70 basis points, for instance.

That may increase worries about the solidity of the euro. Nobody seriously expects it to fall apart—indeed, the euro has protected its more vulnerable members from what might otherwise have been serious currency crises. But Europe may be facing its worst recession since the early 1990s—before the euro existed. This will test the single currency as much as anything else it has faced in its short life.

Russia and the crisis

Kremlinomics

Oct 16th 2008 | MOSCOW
From The Economist print edition

Why the Russian markets have fared worse than others

PRESIDENT Dmitry Medvedev dreams of turning Moscow into a global financial centre, but he has an awful long way to go. For Russia's markets have slumped. Even after recent one-day rallies, the dollar-denominated RTS index and the rouble-denominated MICEX index have shed around two-thirds of their value since mid-May (see chart). These falls are bigger than in any other emerging markets, dealing a blow to Kremlin claims that Russia is a safe haven from global financial turmoil.

Harsh statist rhetoric, the shareholder dispute at the TNK-BP joint venture and the war with Georgia all hurt investor sentiment earlier this year. But the financial crisis has done the most damage. The first big companies to admit being in trouble were in construction, retailing and property. As credit markets all but closed, the cheap loans on which they relied dried up. Companies started to change hands for prices that would have seemed derisory just months earlier. Struggling retail and investment banks, including one that was emblematic of Russia's boom—Renaissance Capital—have been partly or wholly bought by rivals. This week Globex, a small retail bank, experienced a run on deposits. Even Russia's oligarchs feel the pain. Oleg Deripaska, the aluminium king who is the richest of all, has had to unload a big stake in a Canadian car-parts firm after failing to meet a margin call.

So far, ordinary Russians have been less bruised. Many have found it harder to borrow money, but state television has tended to play down the crisis. Big job or wage cuts have yet to materialise. The prime minister, Vladimir Putin, and his loyalist successor, Mr Medvedev, have built their popularity on delivering steadily improving living standards to Russians. Any reverse could unravel the political system they have created.

The Kremlin's response to the crisis has been mixed. Spooked by plunging stockmarkets, regulators have preferred to suspend trading for long periods, and to introduce technical rules to limit the sharpest swings. Frequent market closures meant that London temporarily became a busier marketplace for Russian equities. The Russian markets themselves have lost much credibility.

The main Kremlin plan has been a $200 billion rescue package for banks and companies. The government also plans to buy up blue-chip shares. With the world's third-largest foreign-currency reserves, the depths of the Kremlin's pockets are not in doubt. But many economists fret about the efficiency with which the money will be distributed. And the prospect of the Kremlin taking control of more swathes of the economy will hardly reassure them.

Turkey and the Kurds

Terror in the mountains

Oct 16th 2008 | ANKARA, DIYARBAKIR AND KARS
From The Economist print edition

Renewed violence raises new questions about Turkey's treatment of its Kurds

HER boots caked in cow dung, her hands in soil, 80-year-old Xaje Artuget has but one regret. "I wish all eight of my sons had gone to fight in the mountains," she sighs. In fact, "only one" joined the Kurdistan Workers' Party (PKK) and is now "somewhere in northern Iraq". Similar feelings abound in many hardscrabble townships in eastern Turkey, where decades of repression and poverty have provided a steady stream of recruits since the PKK launched its violent campaign for independence in 1984.

At least 44,000 people, mostly Kurds, have died in the conflict. The Turkish government says it has spent some $300 billion battling the terrorists. The results have been mixed. The PKK leader, Abdullah Ocalan, was captured in 1999, and several ceasefires followed. Yet the violence continues today—17 Turkish soldiers were killed in early October when some 400 PKK rebels raided a military outpost in Hakkari province, near the Iraqi border, and days later rebels killed four policemen in Diyarbakir. Sympathy for the PKK remains strong among Turkey's 14m Kurds.

The Turkish parliament has now extended the army's mandate to bomb PKK targets in Kurdish-controlled northern Iraq, and Turkish aircraft have been doing just that. Yet the latest wave of PKK attacks has embarrassed the ruling Justice and Development Party (AKP) and raised new questions about the army's competence. The cries of incompetence grew louder when *Taraf*, a newspaper, published a leaked internal report showing that the army knew about the planned attack in Hakkari but did little to stop it. It did not help when the air-force chief was photographed playing golf a day later.

In an alarming twist, ethnic tensions are erupting in western parts of Turkey as well. Two people died in the town of Altinova recently when a Kurdish youth rammed a truck into a group of Turks who were taunting Kurds by playing loud nationalist tunes. The army was called in when Kurdish homes and businesses came under siege.

The Kurds remain a huge problem for Turkey's government. The prime minister, Recep Tayyip Erdogan, raised hopes in 2005 when he said the state had "made mistakes" in handling them. Steps to ease bans on Kurdish broadcasting and education followed, and vast sums were poured into Kurdish regions. The handouts included education subsidies for the poor, especially for girls. These helped the AKP to clobber the pro-Kurdish Democratic Society Party (DTP) in much of the south-east in the July 2007 election. Yet to many the measures smell of vote-buying. "I haven't received a penny for my girls' schooling since April," complains Sabiha Celik in Sason. "I will never vote for the AKP again."

Indeed, Kurdish support for the AKP has been fading ever since the government yielded to army pressure to resume cross-border operations against the PKK in northern Iraq. The generals are baying for a freer hand, prompting worries of a return to the human-rights abuses of the 1990s. Ominously, the Turkish

Human Rights Foundation says that, this year alone, over 30 people have been killed in alleged police violence, mostly in the Kurdish region. The government had to apologise when Engin Ceber, a left-wing activist, was tortured and beaten to death by security forces recently in an Istanbul prison.

AKP leaders, who narrowly escaped a constitutional court ban in July, have yet to utter a word about a similar closure case that is pending against the DTP on the ground that it is propagating separatism. DTP deputies spend lots of time lobbying for better prison conditions for Mr Ocalan. Many of them were handpicked by the PKK to run for parliament. Yet just as in the AKP case, much of the prosecution's argument rests on words rather than deeds. Moreover, any ban might just boost the DTP's popularity.

Turkey blames some of its Kurdish woes on the West. "We are still seeing co-operation with the PKK, they are doing fund-raising in EU countries and there are many PKK terrorists living in Europe. This really bothers us," Ali Babacan, the foreign minister, claimed in an interview with *The Economist*. Similar harangues at the Americans have subsided since they agreed to let the Turks pursue the PKK in Iraq.

There are some hopeful signs that Turkey is trying to make friends with the Iraqi Kurds. This week Turkish diplomats met Masoud Barzani, who heads the Kurdish regional government in Iraq. This has prompted speculation that Turkey could be thinking of reviving an amnesty for PKK fighters untainted by violence. As the winter cold sets in, many might be tempted. And, as Mr Babacan acknowledges, "a military solution is not a solution."

German education

Bottom of the form

Oct 16th 2008 | BERLIN
From The Economist print edition

The chancellor looks for ways to improve Germany's mediocre schools

AP

Angela Merkel goes back to school

AMID her other distractions Angela Merkel's attention will on October 22nd shift to a new issue: the poor state of German education. She is gathering the premiers from all of Germany's 16 states for an "education summit" in Dresden. Its vaunted aim is to transform Germany from a mediocre performer into a dazzling "education republic". Yet the chancellor's powers to achieve this goal are limited.

Nobody thinks that Germany can afford mediocrity. If its performance on international tests improved from average to excellent, growth would rise by 0.5-0.8 percentage points in the long run, says Ludger Wössmann, an economist at Ifo, a research institute in Munich. But the real stakes are higher still. Almost half the children in some cities come from immigrant families; many speak mainly their mother tongue. In Germany parents' social status plays a bigger role in children's fates than in most other rich countries. As many as 8% of 15-17-year-olds are school dropouts; unemployment among them is three times higher than among university graduates. Yet, with Germany's population ageing, "who will pay our pensions, if not the migrants?" asks Jörg Dräger, head of education at the Bertelsmann Foundation.

Schools need to teach conduct as well as calculus, ensuring that minorities (and poor Germans) become fully functioning members of society. They are ill-equipped to do it. Germany is one of the few European countries that still divides children up at the age of ten. The cleverest go to *Gymnasien*, the main route to university; the ordinary are sent to *Realschulen*; and the dullards attend *Hauptschulen*, often breeding-grounds for disaffection. Teaching methods have not changed "since the days of the Kaiser," says Ties Rabe, a teacher and Social Democratic member of Hamburg's legislature. Most children leave school before lunch, which is awkward for families with two working parents. Germany has enough child-care places for just a sixth of children under three.

Ideology has often thwarted reform. Social Democrats and others on the left want students of different abilities to spend more time in the same schools. The Christian Democratic Union (CDU), Ms Merkel's party, has long championed the three-tier system, partly because the tierless alternative smelled to many of East German egalitarianism. Yet Ms Merkel must keep her distance. Under Germany's federal system, education is mainly the responsibility of the states. Premiers have no intention of yielding authority. And Social Democrats have the extra suspicion that Ms Merkel may use her education summit to promote the CDU.

Tinkering with education is a risky political business. The CDU and its Bavarian sister party, the Christian Social Union, have been punished in state elections this year by parents angry over their handling of school reforms. Success, if it comes, is often apparent only after decades. But state governments are finding they have no choice. Dwindling numbers of children, especially in eastern Germany, troubled

immigrants in the cities and a flight from *Hauptschulen* are forcing them to rethink how they organise schools. Fortunately a “demographic dividend” from fewer children will free some €8 billion-9 billion a year by 2015 to help pay for change.

Hamburg is more than usually chaotic, with eight types of school at secondary level. A third of its children are from immigrant backgrounds and half are socially disadvantaged, says Alexandra Dinges-Dierig, a former education minister. With the *Hauptschulen* withering, Hamburg plans to merge all varieties of secondary school bar the *Gymnasien* into new “neighbourhood schools” that will offer custom-tailored learning, more practical experience outside school and a slower track to university. Hamburg’s schools have already been liberated from centralised bureaucracy. School directors hire their own teachers, for example.

This is bold stuff, especially coming from a state run by the CDU. But Hamburg’s two-tier structure may become the norm. Berlin and Schleswig-Holstein are doing something similar. More states are testing pre-schoolers’ German, and tutoring those who do not measure up. Until four years ago fewer than half the states had centralised school exams, says Mr Wössmann. Now all but one do, at least for the pre-university test, the *Abitur*. Testing, which helps to make schools more accountable, plus greater autonomy seem to be two of the surest ways to improve schools’ performance.

Ms Merkel’s summit is likely to dwell mainly on what happens before primary school and after high school. Jürgen Zöllner, Berlin’s education minister, hopes it will seek easier entry to university for students without the *Abitur* and come up with money for more social workers and free pre-schools. Mr Wössmann argues that Germany should follow the Netherlands in letting parents spend public money on any type of school they want. But for Germany’s conservative educators, that is likely to be a reform too far.

Italian education

Schools out

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From The Economist print edition

Plans to reform the Italian school system run into criticism

Illustration by Claudio Munoz

ITALY may be facing recession, but for Siggi, a textile firm near Vicenza in the north-east of the country, 2009 offers the promise of unprecedented growth. Siggi is the biggest producer of *grembiuli*, or school smocks. Once universal in Italian primary schools, they were becoming as outdated as ink-wells. But in July the education minister, Mariastella Gelmini, backed the reintroduction of *grembiuli* to combat brand- and class-consciousness among schoolchildren. Siggi's output this year has almost sold out and its chairman, Gino Marta, says that "next year could see an out-and-out boom."

The decision on whether pupils should wear the *grembiule* has been left to head teachers. It does not figure in either of the two education bills that have been introduced by Ms Gelmini. But it has become a symbol of her efforts to shake up Italian education. Her critics argue that these are a vain attempt to turn back the clock; her supporters see them as a necessary first step to a more equitable, efficient system.

On October 30th the opposition she has aroused will culminate in a one-day teachers' strike. The union's main complaint is a programme of cuts aimed at saving almost €8 billion ($11 billion). It includes the loss by natural wastage of 87,000 teachers' jobs over the three academic years to 2012 and the return to a system in which just one teacher is allotted to each year of elementary school.

If this is all the reforms do, they could prove as disastrous as union and opposition leaders predict (international studies find primary schools are the only part of Italy's education that does well). But it is also planned that 30% of the money saved will be reinvested in schools. Ms Gelmini's supporters hope that she will use it to redress the crippling imbalances in education, which is one of Italy's biggest structural economic weaknesses.

One problem is "lots of badly paid teachers", says Roger Abravanel, author of a recent book on meritocracy*. "The number of teachers per 100 students is one of the highest in the OECD." Education, particularly in the south, has often been used by politicians for patronage and job creation. This may explain why, despite studying for longer and in smaller classes, Italian secondary pupils do badly in international comparisons. "The north is around the OECD average, but the south is on a par with Uruguay and Thailand," says Mr Abravanel. Giacomo Vaciago, an economics professor at the Catholic University of Milan, says that "although for the time being the debate is about cuts, the big problem is quality, which is random."

Presenting the latest reforms alongside Ms Gelmini, Italy's prime minister, Silvio Berlusconi, promised that, by 2012, the best teachers would be getting a €7,000 bonus. But Mr Vaciago is unconvinced by the plans. "The present government is making cuts and hoping that the quality comes through as a result. There is no obvious guarantee it will," he comments.

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* Meritocrazia. Garzanti Libri, Milan.

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Charlemagne

Bad times ahead

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A deep recession would be a big challenge for the European Union

Illustration by Peter Schrank

FEW governments enjoy recessions. But the looming one poses a special threat to the European Union—a group of countries held together by overlapping pacts of solidarity. In the EU, solidarity is guaranteed by law, rhetoric and plenty of money. Take away the money, and it can start to look awfully fragile.

Over the decades European solidarity has achieved many good things: the creation of the single market and enlargement to the south and east among them. Now 27 countries share a union based on the rule of law, open borders and the free movement of people, goods and capital, and 15 share a currency. To make it all work, poorer countries receive hefty aid in exchange for opening their markets to their richer neighbours. The prospect of new markets reconciles old Europe to cheaper competition from newcomers. Rules limiting state aid ensure a level playing-field. And Europe also offers a more nebulous pact of solidarity between rulers and ruled. This is based on a “social model” that may not offer the same prospects of getting rich as the American model, but promises to soften the sharp edges of globalisation.

A nasty recession will thus have political consequences for Europe. If inflation and unemployment rise sharply, EU solidarity could break down in some damaging ways. There may well be a surge in what one ambassador calls “the politics of nostalgia”. Faced with harder times, voters may fall for politicians offering old solutions, or a return to an imagined, golden past.

One early casualty could be the EU’s plans to fight climate change. At this week’s EU summit, Germany and several of the east Europeans lobbied to water these down to meet their national interests. Italy’s Silvio Berlusconi broke a bigger taboo by questioning the very design of the deal agreed in March 2007. Meeting carbon-cutting targets should wait until after the financial crisis had passed, he suggested: it was no time for Europe to play “Don Quixote” and tackle climate change alone.

In truth, fear of job losses is undermining the EU’s whole climate package. Governments everywhere now talk of “carbon leakage”: the threat that traditional industries generating lots of greenhouse gases, like steelmakers, will move elsewhere if the EU imposes extra costs on emissions. This frustrates countries like Denmark, whose government thinks that future wealth will lie in green technology and energy efficiency (the Danes are big in windmills). Connie Hedegaard, the Danish climate minister, says that Europe must focus on “sustainable” future sources of jobs, not wallow in nostalgia. “Why are we looking to sunset industries, instead of promoting industries of the future?” she asks.

The EU's promises to combat climate change are, in effect, a pact of solidarity between the generations. When European leaders agreed to the March 2007 targets, they accepted the logic that it would cost less to cut emissions now than to adapt to the future effects of unchecked climate change. That seemed to reverse politicians' usual instincts, which are to win elections by bribing today's voters (with tax breaks, early retirement schemes etc) and quietly sticking their future grandchildren with the bill. Now, it seems, European leaders did not really accept the new logic 18 months ago: they were just feeling rich and in a mood to make bold promises. Now that money is tight, solidarity with future generations is a distant memory.

What about between countries? Some rich ones, notably France, are already exploiting the economic downturn as a pretext to demand that EU competition rules be relaxed, so that favoured domestic industries (such as French cars) can be subsidised. Global solidarity is at risk too. The EU agenda for the coming year includes work on asylum seekers and plans to make Europe more welcoming to skilled, legal migrants from outside the union. Don't hold your breath for anything liberal. Within the EU freedom of movement could go either way. The slowdown in western Europe is prompting migrants to head back to home countries like Poland, easing tensions over immigration. A broad EU-wide recession, which could hit eastern Europe hard, would end such happy effects.

An Irish conundrum

Brussels is also full of people who see the financial crisis as proof that Europe needs the Lisbon treaty, a set of institutional changes meant to make it quicker and easier to pass new EU laws. But Lisbon cannot happen unless Irish voters reverse their rejection of the treaty in a referendum last June. In the EU's corridors October 2009 is now quietly being touted as an ideal date for a second Irish referendum. Claims that a new Irish vote might be hard to win are brushed aside: Ireland must accept its responsibilities, and make every effort to ratify Lisbon, huff Euro-grandees (and leave the EU if it fails, murmur the hard-core federalists). Yet Ireland faces perhaps the deepest recession of all. Bullying its prime minister, Brian Cowen, into holding a new referendum could amount to leaving whisky and a loaded revolver in the study and expecting him to do the decent thing for Europe.

The "politics of nostalgia" poses another threat. One of the main changes in the Lisbon treaty would be to give more power to the European Parliament. That may not look such a good idea after the June 2009 European elections. Euro-elections are always a good opportunity for a protest vote (few Europeans care much who they elect). A toxic combination of unemployment, home repossessions and inflation could benefit extremist parties from left and right, predicts one official, leaving Europe with what he terms a "lopsided" parliament.

It is a cliché of European politics that the EU achieves its greatest advances in times of crisis. That seems optimistic this time. Generosity and enlightened self-interest are at the heart of the European project. But neither today's enlarged EU nor Europe's single currency has been through a really deep recession: European solidarity is facing its severest test.

Public finances

Counting the cost

Oct 16th 2008
From The Economist print edition

The big worry is not the bill for the banking rescue but the impact of recession

Illustration by David Simonds

ON OCTOBER 8th, when the Treasury announced its bail-out plan for British banks, Alistair Darling had been due to deliver a speech on how he intended to patch up the government's already frayed fiscal framework. The lecture was cancelled when the chancellor of the exchequer decided that this was too much excitement for one day. If nothing else, the Treasury needed to work out the full budgetary implications of its rescue package.

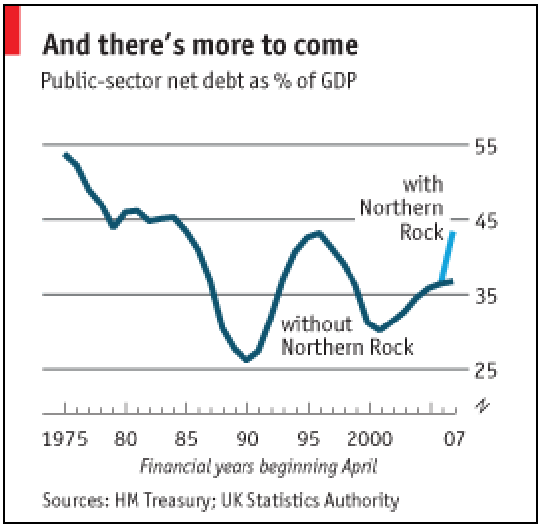
At first sight these are horrendous—and rising. When Mr Darling set out the plan, he envisaged having to inject up to £50 billion ($87 billion) of public money to bolster banks' capital, with an initial outlay of £25 billion. But by October 13th the first tranche was already as much as £37 billion—the amount needed to recapitalise just three banks, Royal Bank of Scotland (RBS—£20 billion), HBOS (£11.5 billion) and Lloyds TSB (£5.5 billion), assuming shareholders made no contribution. Whereas the initial plan had envisaged the state acquiring safer interest-bearing preference shares, £28 billion out of the £37 billion would now be in riskier ordinary shares.

On October 16th details of the plan were under revision, after a fall in banks' share prices provoked a plea from their bosses for scope to pay dividends on ordinary shares before preference shares are redeemed. Whatever the fine print proves to be, the bail-out, as a financial transaction, will not add to the usual measure of the budget deficit, but it will certainly push up public debt. The first instalment alone will raise debt by 2.5% of GDP, as the Treasury borrows to finance its recapitalisation of the three banks (which will become two if the planned takeover of HBOS by Lloyds TSB goes through).

The rescue is the latest blow to Gordon Brown's commitment to keep public debt at a sustainable level, long defined by the Treasury as below 40% of GDP. In 2006-07, the fiscal year before the banking crisis, the government was abiding by this rule: net debt stood at 36.5% of GDP. But in 2007-08 it jumped to 43.4% (see chart), mainly because of the inclusion of around £100 billion of liabilities at Northern Rock, the first mortgage lender to end up in state hands.

This month's banking rescue, together with the recent nationalisation of Bradford & Bingley, another stricken mortgage lender, will take net debt to around 50% of GDP, the highest for over 30 years, according to the Institute for Fiscal Studies (IFS),

a think-tank. Yet debt will shoot up farther still—to wartime levels—if official statisticians decide to include the huge liabilities of the three banks the Treasury is recapitalising. That seems quite likely for RBS, of which the state may end up owning around 60%, although under national-accounting rules, the judgment hinges not on public ownership but on whether the state controls corporate policy. This bank alone would raise public debt by more than 100% of GDP.



Such a ballooning in the government's liabilities may seem ominous, but this is to look at only one side of the public balance-sheet now that the Treasury has turned banker: on the other side stand the assets. As David Miles, an economist at Morgan Stanley, a bank, suggests, the debt measure that matters is one excluding the banks' liabilities. The real risk to taxpayers is that loan losses will destroy some of the capital supplied to the three banks and the support provided for Northern Rock and Bradford & Bingley. In 40 banking rescues studied by Luc Laeven, an economist at the IMF, the taxpayer typically recouped some but not all of their cost.

Set against this, the stakes are intended to be temporary, and the public purse could profit when the shares are eventually sold. Taxpayers could also make running gains from the overall package, says Ben Broadbent, an economist at Goldman Sachs, a bank. Although the Treasury will have to pay interest on the new gilts it issues to fund the recapitalisation, it will recoup over half of this from the 12% interest its preference shares in the banks will earn. It will also charge fees for the guarantees it is providing on £250 billion of new debt issued by British banks—another part of the rescue package. Putting it all together, Mr Broadbent estimates that the net gain to the exchequer—assuming it does not have to pay out on the guarantees—could be nearly £3 billion a year.

But although the direct fiscal effects of the banking rescue may be surprisingly small, the overall budgetary outlook has taken a sharp turn for the worse. Even before the financial woes of the past month, the economy was sliding into recession. It is a worrying sign that the jobless rate jumped to an average of 5.7% between June and August, from 5.2% in the previous three months. The IMF now expects British GDP to contract (albeit by only 0.1%) in 2009, the first full-year decline since 1991.

Recessions wreak havoc on the public finances by both cutting tax revenues and raising unemployment-related spending. For every percentage point that GDP is lower than expected, public borrowing will be roughly £7.5 billion higher than forecast in the first year, rising to £10 billion higher in the second year, according to the Treasury's ready reckoner. If the economy were simply to stall in 2008-09 and 2009-10, this could double planned borrowing of £38 billion next year; if output were to contract over the period the outcome would be costlier yet.

Making matters worse, the shape of the probable recession is likely to inflict particular fiscal pain. In recent years the Treasury has reaped a rich harvest from a flourishing City, as the financial sector has paid around a quarter of corporation tax. It has also done well out of the housing boom through rising stamp duties incurred on home purchases. Now both these sources of revenue are drying up in a downturn that is concentrated in banking and property. And, unhelpfully, higher-than-expected retail-price inflation of 5% in the year to September—the figure used to adjust welfare benefits in 2009-10—will add £3 billion to spending in the next financial year.

If Mr Brown had done a better job of looking after the country's finances while he was chancellor, the fiscal outlook now would be less dire. But he allowed deficits to persist even in years when the economy was growing strongly, as in 2006-07. As a result, forecasters are now sharpening their red pencils. The IFS expects the budget deficit to rise to 4.4% of GDP in 2008-09. Goldman Sachs thinks it will reach some 6% in 2009-10.

These estimates are gloomy, but they would be much worse had an attempt not been made to stabilise the banking system and avert a more severe recession. In this sense, the rescue will pay for itself, even if it does result in losses for the taxpayer.

Scottish banks

Political dividends

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The financial crisis bodes ill for Scottish independence

NO SOONER had Scots absorbed the humiliation of seeing their two biggest banks part-nationalised to avoid collapse than the battling began. Within hours all pretence of maintaining a statesmanlike consensus over the bail-out of Royal Bank of Scotland (RBS) and HBOS (formed by the merger of Halifax Building Society with Bank of Scotland) had vanished. Gordon Brown saw a chance to attack the Scottish National Party (SNP), which has been cutting the ground out from under him—and even, perhaps, to snatch victory in a critical Scottish by-election on November 6th.

An independent Scotland could not afford the £20 billion ($35 billion) earmarked for RBS and the £11.5 billion for HBOS, thundered Mr Brown on October 14th: the bill for these capital injections in exchange for shares is bigger than the devolved Scottish government's entire budget of £31.3 billion. Labour MPs have gleefully waded in too: Iceland's collapsed banks and the emergency tax-raising budget in recession-hit Ireland this week suggest that the small independent countries praised by Alex Salmond, Scotland's first minister and leader of the SNP, are part not of an "arc of prosperity" but of an arc of insolvency.

Mr Salmond protests that he would not have tolerated the lax regulatory regime that Mr Brown has presided over, first as chancellor of the exchequer and now as prime minister. And an independent Scotland, he claims, would be more like Norway, another small, prosperous nation that shored up its banks in the 1990s, invested its oil receipts wisely and, in contrast to Britain, is a "sea of stability" today. But Mr Salmond's independence bid is predicated on a strong financial sector and an upwardly mobile oil price. With the two biggest Scottish banks in trouble and oil down below $80 a barrel, that dream looks less attainable.

Mr Brown has his own problems, however, now that the first fine careless rapture over his plan to save British banking is ebbing. If the government stands ready to recapitalise all big banks, many question whether the takeover of troubled mortgage lender HBOS by Lloyds TSB, brokered by Mr Brown in September, need go ahead. Tavish Scott, leader of the Scottish Liberal Democrats, is one who wants it stopped: the merged bank would have 30% of British mortgages and leave Scotland the most concentrated banking market in the country. Shareholders in Lloyds TSB are lukewarm too, claiming that only the HBOS rescue has driven them to seek official capital, with its onerous restrictions. All three banks were talking to the government at mid-week about scrapping the requirement to suspend dividends on ordinary shares until preference shares are redeemed.

Amidst all this, Mr Brown's gaze is fixed firmly on the forthcoming election in Glenrothes, next door to his Kirkcaldy seat. On October 15th he rallied the Labour troops, announcing that he and his wife—a newly discovered political asset—would be visiting the constituency, and urging others to do likewise. Despite a Labour majority of 10,664 at the previous election, it was thought to be an SNP shoo-in this time. "Now," says Nigel Griffiths, a Scottish Labour MP, "I'm thinking we could win Glenrothes."

School examinations

Tested, and found wanting

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From The Economist print edition

The government does a U-turn on controversial exams for 14-year-olds

PERHAPS it was the praise showered on his boss, Gordon Brown, for getting on with rescuing banks that encouraged Ed Balls to take decisive action. On October 14th the schools secretary told Parliament that he was abolishing the "standard assessment tests" (SATs) in English, mathematics and science for 14-year-olds, which were, he said, "less and less relevant". The SATs taken by seven-year-olds and marked by their teachers as well as the externally-marked ones for 11-year-olds would continue. But even this partial climb-down will have embarrassed a government that has long seen SATs as vital to improving teaching and informing parental school choice.

In reality, the decision had little to do with a dawning ministerial realisation that the tests are pointless: the arguments against SATs have been made loudly, often and long. Rather, it was forced by the chaotic marking of them this summer by ETS, an American firm. Requests for re-marks rocketed and some schools are still waiting for their results, three months late. ETS was fired in August, just one year into a five-year contract, losing £50m as a result.

That left the government scrambling to find a replacement. But two of England's three big exam boards—the only candidates with the experience needed to hit the ground running—have ruled themselves out, so choice is limited. Since the tests for 14-year-olds are the hardest to mark, dropping them may have been the only way to salvage SATs for 11-year-olds.

Mr Balls has got rid of the weakest link in the long chain of tests taken in English schools (there are no SATs elsewhere in the United Kingdom). Pupils do not change schools at 14 and so do not need a portable record of their achievement at that age. And parents look at GCSE results, not SATs, when choosing secondary schools.

Some think Mr Balls should have gone further: "The government has missed an opportunity to sweep away the whole thing," says Mick Brookes of the National Association of Head Teachers. He, and others, think the gains from SATs at any age are not worth the costs, which include a narrowing of the primary curriculum and ever-increasing teaching to the test.

The abolitionists have no chance of persuading the government to drop the tests entirely. Before they were introduced in the 1990s, no one—not teachers, parents or the state—knew just how many children left primary school unable to read, write or add up. But their arguments have persuaded the government to look for ways to mitigate the costs for schools and students.

One proposal is to replace the current exams-driven league tables with "balanced scorecards" which grade schools on a raft of measures, including exam results, attendance and pupils' health. That may help: no more dropping sports in order to squeeze in extra drill on exam technique. Another, which is now being piloted, is to replace the SATs for 11-year-olds with "single-level tests" modelled on music exams, for which teachers can enter pupils twice a year at the level they judge appropriate. The idea is that rather than forcing all children to take a D-Day exam at the end of primary school, credit is collected along the way when it is earned.

But Alan Smithers, of Buckingham University, warns that single-level tests are no panacea. Teachers will struggle to prepare children in the same classroom for different exams. Examiners will struggle too, to produce a single test that measures the same level of ability in children of different ages. (In music tests all candidates for a given grade play the same pieces: in an English test, quite different reading texts and writing topics would suit an eight-year-old than an 11-year-old.) The changes might even have the perverse effect of making children sit more tests. "To the extent that schools are judged on results, they have a vested interest in getting as many children through tests at as high a level as possible, as quickly as possible," Mr Smithers says. "They may be tempted to test children repeatedly, knowing they can bank the passes, and ignore the fails."

Detention without charge

Down but not out

Oct 16th 2008
From The Economist print edition

The Lords deal a blow to the government's anti-terrorist plans

PA

Well, get on with it

IT WAS the biggest rebellion by the House of Lords since most of its hereditary members were sent packing in 1999. On October 13th the second chamber voted by 309 votes to 118 to keep the period for which a terrorist suspect can be detained without charge at 28 days. The government's counter-terrorism bill, which sought to raise the limit to 42 days, had squeaked through the House of Commons in June. But the unelected Lords, jealous of their independence and the nation's liberties, were always likely to vote it down.

More surprising was the alacrity with which ministers gave in. Gordon Brown has backed longer pre-charge detention since before he became prime minister (his predecessor, Tony Blair, had raised the limit in stages). But after the Lords vote, Jacqui Smith, the home secretary, announced that the bill would be stripped of the offending proposal. Another clause, allowing the government considerable leeway to restrict public inquests, was also jettisoned.

Quite a retreat, then, but civil libertarians should not assume that the government has wholeheartedly converted to their cause. For one thing, the controversial clauses are not dead: ministers have drafted a separate bill allowing for an extension to 42 days, which would go before Parliament if an emergency required it; and the changes to inquests will reappear in the coroners bill next year.

Moreover, political realism called for a retreat. Relying on the Parliament Act for the Commons to override the Lords' wishes would have delayed the bill and its many sensible provisions, such as more freedom for police to question suspects after charging them. It would also have required another vote by MPs, which the government was unlikely to win. As well as being emboldened by the Lords, Labour MPs who voted for 42 days with great reluctance in June can now dare to rebel without fearing to bring down their leader. Mr Brown's position was shaky in the summer; it is more solid now.

Liberals can take heart, though, that opposition to 42 days has grown to become something like an establishment consensus. Lord Carlile, the independent reviewer of anti-terrorist laws, defended the proposal, debunking some of the civil- liberties lobby's more dubious claims. But he was outnumbered by retired lord chancellors, former police chiefs and the ex-head of MI5. They noted the lack of evidence that the police needed more than 28 days, and said the various parliamentary safeguards offered by the government made the measure unworkable anyway.

Even the public, often assumed to be squarely behind the government on tough counter-terrorist proposals, is hard to read. A YouGov poll in June that asked whether "terrorist suspects" should be detained for up to 42 days found 69% in favour. But support fell to just 36% in an ICM poll in July, which asked whether people who "may be innocent or guilty of a terrorist offence" should be detained for six weeks.

There are consolations for ministers in all this. Voters seldom punish governments for being too tough on national security. Though no politician can say it openly, a terrorist attack (or even news of a major plot) could yet transform the debate. And the truce over the issue within the Conservative Party (David Davis, who quit as shadow home secretary in June to campaign for civil liberties from the back benches, says he gets no complaints from more hawkish colleagues) may then unravel. The Tory Lord Tebbit warned his party on October 13th that a future Conservative government could find itself requesting the same powers that it has opposed under this government. A case for 42 days may indeed emerge in future. But as the scale of the government's rout in the Lords made clear, there isn't one now.

The database state

A solution in search of a problem

Oct 16th 2008
From The Economist print edition

Labour's ID-card scheme is in trouble, but new types of snooping loom

Illustration by Claudio Munoz

THE government's now-shelved plan for 42-day detention is not the only proposal to have provoked portentous warnings about threats to ancient British liberties. Ministerial enthusiasm for a £4.7 billion national identity-card scheme (and the database that would power it) has elicited warnings about cost overruns and data-security risks from sober commentators and comparisons with the Gestapo from more colourful ones.

The government's countering argument is protean. Ministers have variously claimed that the cards would offer protection from benefit fraud, terrorism and illegal immigration, and that they would make access to public services easier. But a combination of public opposition and organisational ineptness has left the ID- card scheme floundering.

In theory, a nationwide chain of 69 "interview centres" should now be interrogating and taking fingerprints from the 600,000 people who apply for or renew a passport every year, so that their details can be added to the ID-card database. But according to Phil Booth, national co-ordinator of No2ID, a campaigning outfit, officials managed to interview only around 90,000 people in the scheme's first year of operation.

Opposition has been growing among early adopters too. Ministers had hoped to smooth over dissent by introducing the cards gradually, beginning with students, foreigners, airport workers and other soft or sensible targets. But pilots (who count as airport workers) "object to being guinea pigs", according to Keith Bill of the British Airline Pilots Association, a trade union that is pondering legal action against the government. Students have proved just as obdurate. This week sees the end of mylifemyid.org, a government website set up in July, purportedly to allow 16-to-25 year olds a chance to comment on ID cards. Widely dismissed as an inept propaganda exercise, the site has generated overwhelmingly negative feedback ("Don't need, don't want," runs one pithy post; "A flimsy attempt to make people easier to control", says another). To the government's credit, it has not deleted such messages.

Now bigger beasts are stalking the scheme. At their annual conference in September Britain's trade unions resolved to oppose ID cards. Three weeks later, at their own conference, the opposition Conservatives reiterated their promise to scrap the plan should they win the next election, which looks entirely possible. The Tories have also promised to abandon ContactPoint, a huge database designed to track everything from educational details to contact with social services for every child in Britain.

Opinion polls show that public support for ID cards has fallen sharply over the past four years, but even a chorus of opposition has not muted the government's centralising instincts. On October 15th Jacqui Smith, the hyperactive home secretary, announced plans for a gigantic £1 billion database that would store the details (but not the content) of every phone call and e-mail sent in Britain, for the benefit of the police and spy agencies. Expect the rhetoric about ancient freedoms to heat up.

Bagehot

The riddle of Gordon Brown

Oct 16th 2008
From The Economist print edition

How did Britain's hapless prime minister become the saviour of the universe?

Illustration by Steve O'Brien

"SAY what you like about Boris Yeltsin," said one pithy obituarist of Russia's mercurial president, "and you're probably right." Say what you like about Gordon Brown, it seems, and you'll eventually be right too. He is a tin-eared, cack-handed no-hoper, the anti-Midas of politics; but also, now, an economic seer, globalisation's therapist, lionised by the European media, saluted by leaders who once disdained him and hailed by the new Nobel economics laureate as the man who may have saved the world financial system. If Hollywood ever makes a film about the crash of 2008, Mr Brown may be the reviled but ultimately vindicated nerdy hero (played by Tom Hanks).

Two questions arise from this stunning metamorphosis—one about the future, and another, perhaps more vexing, about the past. The historical one is this: can the prime minister who had sunk beneath criticism into ridicule really be the same man who, last week, called for the world to emulate his bank-rescue package, and saw the world obey? Which is the real Mr Brown?

There are a couple of conveniently easy answers to this riddle. Some somersaulting left-wing commentators—who were for Mr Brown before they were against him, and are now for him again—explain his inconsistency and their own as the unpredictable result of historical lightning, an act of the political gods. Some in the right-wing commentariat, meanwhile, insist that Mr Brown's triumph has been chimerical. The crisis he apparently helped to ameliorate, they say, is actually his fault, at least as much as it is that of the nefarious bankers and irresponsible Americans whom he himself alternately blames. Moreover, Mr Brown and Alistair Darling, the chancellor, were slow to announce their recapitalisation plan, and will soon struggle with the politically awkward burden of controlling a big chunk of the banking sector. Some in this camp spy a revanchist Labour socialism to which, they believe, Mr Brown has always secretly subscribed.

Both these explanations are wrong. The latter is a classic example of what psychologists call cognitive dissonance: accustomed to seeing Mr Brown as "useless" (as David Cameron, the leader of the Conservatives, puts it), some observers find it impossible to acknowledge his success. But it is real: whatever his past mistakes, Mr Brown's tripartite plan for rescuing Britain's banks was bold, comprehensive and swiftly copied elsewhere. He and Mr Darling may have dithered for a day or two, but they were still speedier than other European leaders and the hapless Hank Paulson. And the idea that Mr Brown has been unrecognisably transformed is also mistaken. Mr Brown the flop, and Mr Brown the saviour of the universe, Bagehot submits, are more similar than they may at first appear.

In his response to the crisis, Mr Brown has demonstrated many of the traits that contributed to his ruination before. One is a fondness for plagiarism. He is a natural copycat, as he demonstrated to his cost last year when he imitated a sketchy Tory idea to ease inheritance tax by squeezing "non-doms". But well-judged plagiarism can be a desirable, even an admirable, skill in a leader, as it is proving now. Mr Brown borrowed elements of Sweden's bank-rescue package of 1992, plus ideas advanced by the Tories and others, and worked them into a proposal that he victoriously presented as his own.

Next, Mr Brown's taste and fitness for austerity. For part of his short premiership, he tried—and failed—to proffer himself as the champion of a different abstract noun: aspiration. But he has always seemed constitutionally inclined to worry more about averting bad things (poverty, inequality and so on) than about making good things happen. His natural political costume is the hair shirt. Along has come a potential catastrophe, the partial aversion of which seems heroic rather than dully worthy.

Finally, Mr Brown finds himself in his natural element in macroeconomic meltdown, just as Tony Blair was in questions of liberal interventionism. He is not expected to emote or empathise or discharge any of the other awkwardly human duties of routine political leadership. Instead he can talk fluently about the lessons of past crises and his suddenly fashionable plans for reforming the global financial architecture. He can revert, in other words, to the staid but commanding persona he honed as chancellor. Another way of putting it is that Mr Brown can sail, for the moment, above ordinary politics. And it is lowly politics—positioning, spinning, over-promising—that got him into trouble.

Time for a change

The pressing question about the future is not really whether Mr Brown's crisis bounce will be high and lasting enough to win a general election. Although the stock of embattled politicians can evidently go up as well as down, that still seems unlikely; but the election will probably not come before 2010, by which point a recession will have intervened, with unpredictable consequences.

The pressing question is whether Mr Brown can become a lastingly effective prime minister. Leaders, like banks, run on a self-perpetuating cycle of confidence: seeming confident inspires the faith of voters, which in turn can free leaders to govern decisively. Mr Brown has been bold, and has been applauded for his boldness. Soon he will have to take decisions without the liberating urgency of emergency, and with an opposition no longer trapped, as oppositions often are in crises, between seeming irrelevant and seeming indecently opportunistic. Mr Brown's "bottling" of a snap election last autumn defined the politics of the year that followed; can he now sustain the political and intellectual momentum he has gathered in the forthcoming one?

Mr Brown is a complex man—talented and resilient as well as brooding and clumsy—whose virtues are inextricably bound up with his faults. Both the laughing stock and the deep-thinker are the real Mr Brown. Circumstances changed, not the prime minister. To prosper after the panic ebbs, he still needs to.

Biodiversity

Fewer creatures great and small

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From The Economist print edition

Nature needs a bail-out, say those who fear that a poorer, hotter world will bode ill for life's infinite variety

NaturePL

GREEN-MINDED folk of many shades came to Spain this month, to talk about the need to save from human recklessness as much as possible of nature's bounty of genes, habitats and species. They brought bad tidings. Common birds are in decline across the world. Almost one in four species of mammals is in danger of extinction. If current trends continue until 2050, fisheries will be exhausted. As it is, deforestation costs the world more each year than the current financial crisis has cost in total, one economist argued.

In theory, virtually all the world's governments are committed to limiting the damage. In 1992, at the Earth summit in Rio de Janeiro, they signed a treaty called the Convention on Biological Diversity (CBD). In 2002, under its auspices, they vowed to bring about "a significant reduction" in the rate of loss of biodiversity by 2010. The pledge became one of the Millennium Development Goals, the United Nations' eight fondest ambitions for the world.

Yet this target now looks unattainable, said most participants at the World Conservation Congress, which concluded in Barcelona on October 14th. The meeting was awash with gloomy forecasts. The International Union for the Conservation of Nature (IUCN), the network of conservation groups that organised the congress, released the latest version of its "red list" of threatened species. It describes the health of all species whose populations have been assessed—almost 45,000 this time round. At first glance, the proportion of species at risk seemed to have fallen slightly. But that, the compilers note, simply reflects the expansion of its coverage beyond the creatures seen as most in danger. Of 223 species whose status has changed since last year, 82% were closer to extinction.

The IUCN also released a "comprehensive assessment" of the status of all known species of mammals. It found that 22% were threatened or extinct, and the well-being of a further 15% was unknown. For amphibians, the outlook is grimmer: a full 31% of them are at risk, and the status of a further 25% is uncertain. Sampling of species in other categories suggests similarly dire outlooks, with some 24% of reptiles and 32% of crabs thought to be threatened. For the most part, these findings do not reflect the latest data on global warming. But another IUCN study released at the congress found that 35% of the world's birds, 52% of its amphibians and 71% of its warm-water corals were "particularly susceptible" to the threats from warming.

Last year, the Intergovernmental Panel on Climate Change, which is studying global warming for the UN, said 20-30% of species could die out if global average temperatures rise by more than 2°C or so. And even today's rate of extinctions, one Barcelona delegate noted, is 1,000 times faster than the norm before man made a mess.

What does the loss of other species cost humans? Many congress-goers talked about valuing "ecosystem services": natural processes that benefit people, such as the pollination of crops, the purification of water in wetlands and the sequestration of carbon in soil and forests. A study released this year said the world was losing €50 billion ($68 billion) in ecosystem services each year because of damage to nature.

Biodiversity underpins ecosystem services. Bees can't pollinate, nor can trees store carbon, if they have all died. And it seems to matter that ecosystems contain more than a handful of species. Diverse systems are better at capturing carbon, storing water and preserving fisheries. Just how diverse an ecosystem has to be in order to supply the goods and services needed by man is a matter of debate—a debate made harder by the fact that many species may have uses that man has not yet found. And regardless of its uses for humans, many see a moral imperative to save biodiversity. Ecuador's new constitution duly confers on ecosystems "the inalienable right to exist, flourish and evolve".

In a report for the British government, Johan Eliasch, a businessman and environmentalist, suggests a virtuous circle: climate change could be slowed, biodiversity saved and poverty alleviated if forests were included in carbon markets. Deforestation is responsible for so many emissions that allowing countries to claim carbon credits for reducing the pace at which they cut down their forests could cut the cost of halving global carbon emissions from 1990 levels by 2030 by 50%. And, in the process, deforestation rates would be reduced by 75% by 2030. But this would cost the rich world money: $4 billion over the next five years, and a further $11-19 billion a year by 2020.

In the short term, there is little sign of governments becoming better stewards of nature. Only 30 or so of the 191 countries that are party to the CBD have made plans to protect biodiversity, as the treaty demands. Another study released at the congress found that the world's biggest economies were spending only a fraction of the money needed to police protected areas; they were also falling short on legal and administrative measures needed to stop the spread of invasive species and eradicate the trade in endangered species. Money, of course, is likely to get tighter as the world economy slows and governments rescue struggling banks.

Many at the congress said that nature, too, needed a bail-out. As Andrew Mitchell of Global Canopy Programme, a forest-conservation group, puts it: "Rainforests work as a giant natural utility company. If we don't start paying for it, we will get cut off. Instead of simply preventing the next global credit crunch, it is time to start thinking about averting the rainforest crunch as well." Julia Marton-Lefèvre, the head of the IUCN, agrees. "Business as usual is simply not an option," she says. But that is the option many governments seem to be choosing.

Economist.com WORLD INTERNATIONAL

Religious diversity

Mergers, acquisitions and spin-offs

Oct 16th 2008 | AMSTERDAM, BELFAST AND MOSCOW
From The Economist print edition

When Christian groups reunite, watch out for the next split

ON THE southern rim of Moscow, where the din of traffic gives way to a silent forest, three steeples shimmer over the trees. On closer inspection, these belong to a magnificent new church. Inside it, and in a much cosier wooden edifice next door, every inch of wall commemorates people who were massacred in this area 60 years ago. Many are depicted in icons, celebrating them as martyrs whose prayers in the afterlife protect the church.

This memorial to victims of Stalin's purges (albeit mainly recalling one category, Christian believers) sends a timely message to a Russia where reflection on the perils of an over-mighty state is rare. Its construction is one reason why, last year, most of the New York-based Russian Orthodox Church Outside Russia (ROCOR) agreed to unite with the Patriarchate of Moscow, which "White" anticommunist exiles long saw as tainted by red links.

As one condition for reunion, ROCOR had insisted that due honour be shown to the so-called "new martyrs" who died for their faith under the Soviet regime. Visiting the memorial near Moscow, it seems hard to deny that this demand has at least in part been fulfilled. To many people, reunion seemed irreversible after Moscow's Patriarch Alexy joined the late head of ROCOR, Metropolitan Laurus, in laying foundations for the Butovo church.

But for a passionate minority of ROCOR clerics and believers, dotted across North and South America, Europe and Australia, the Moscow-based church hasn't gone nearly far enough to justify coming together. For these dissidents, it matters a lot that hierarchs in Moscow still approve the accord made with the communists in 1927 by Sergius, an Orthodox bishop who signed a statement accepting the Soviet Union as a "civil motherland". By justifying Sergius, the dissidents insist, the Moscow church implicitly condemns others who went underground or remained defiant and paid with their lives.

The dissenters' argument is that by defending deals made under the Soviet regime, today's church is endorsing a Soviet-era episcopate which not only obeyed Stalin but fawned on him. Supporters of the reunion retort that most of today's Russian episcopate was elevated after the Soviet period; they also hope that the reunion will help along a continuing reassessment of all eras of Russian history. Across the Russian diaspora, the dispute has divided parishes and formerly close-knit communities. Priests have broken with bishops, theology students with their professors.

The intra-Russian dispute is only one example of a paradox in the recent history of the world's largest religion. Almost every time two Christian communities—split by politics, race, culture or doctrine—decide to reunite, a new division is created by those who cannot accept the merger.

In Christendom as a whole, most recent merger activity has been among schools of Protestantism which now feel that doctrinal differences between John Calvin (1509-1564) and Martin Luther (1483-1546) shouldn't be a make-or-break matter in the 21st century.

The Geneva-based World Council of Churches (WCC), an association of about 350 Christian groups, has counted 50 "reunited" churches (all involving varieties of Protestantism) and 40 churches that are engaged in talks that could lead to further mergers. But not even the WCC's keenest enthusiasts are sure that the movement towards unity is stronger than the trend towards fragmentation.

In any case, for Roman Catholics and Orthodox Christians the idea of a "reunion" between churches is paradoxical, if not contradictory; they speak of the Church as a mystical reality of which they are the main or sole representatives, and which almost by definition cannot be divided. For Protestants, the idea at least of "uniting churches" is not so problematic. A dozen intra-Protestant mergers have been modelled on one that occurred in Canada in 1925. India is one of the few countries where Christians who

defer to bishops managed to merge with those who don't.

But the world's fastest-growing sects, typically those stressing dramatic personal experience, such as speaking in strange tongues, are uninterested in uniting with anybody. They view the WCC as soft-minded or worse. In this they resemble the "White" Russians, who also abhor the Moscow Patriarchate's membership of the WCC. (The Muscovites this week left the Conference of European Churches, a WCC affiliate, but that probably won't satisfy their most conservative critics.)

Going Dutch and divided

Even among those who are interested in reunion, recent news is mixed. In South Africa, the mainly black and coloured Reformed churches have voiced dismay over the refusal of their white compatriots in the Dutch Reformed church to accept their terms for union. While the white Dutch Reformers have eschewed their old belief in apartheid, some couldn't quite swallow the "Belhar Confession", a document written in 1986 which stresses racial and social inclusiveness.

In those quarrelsome South Africans' spiritual home, the Netherlands, intra-Protestant rows also smoulder on in some places. That is despite (or rather, because of) a giant merger sealed in 2004.

This involved the two biggest Reformed groups, plus a few Lutherans; it seemed to many people like a good outcome of a rapprochement that had been under way for 40 years. But not all approved. In the Dutch "Bible belt" from the Zeeland islands to the eastern border, some 60,000 people established a new "Restored Reformed Church" professing true Calvinism.

Some of the issues at stake are familiar from other Christian battlegrounds, such as the Anglican Communion, where the question of gay rights has split southern-hemisphere conservatives from northern liberals. The Dutch traditionalists reject female pastors and same-sex unions. But the Dutch old-timers' deeper objection is to sloppy mixing of two traditions: their own Calvinism, stressing the "depravity" of mankind, and the Lutheran view, which is a bit gentler. "We pledged to follow the original Reformist path, and it is a biblical calling that you must continue to do what you promised," says Willem van Vlastuin, a "restored" church pastor who serves 1,300 souls in the coastal town of Katwijk.

Before 2004, conservatives in the Netherlands' reformed churches (there were two with similar names) could rub along with the liberal camp because they still belonged to bodies that claimed, at least, to be Calvinist. Once the waters were muddied by throwing in a new, Lutheran set of beliefs, the conservatives marched out. Just as happened with the Russian reunion, some clerics hovered between the amalgamated body and the dissidents, in a few cases switching sides more than once.

In Protestant redoubts such as Scotland and Ulster, there are sects (small in numbers but still dominant in certain places, like the Scottish island of Raasay) which glory in the fact that they or their forebears rejected past efforts to patch over differences. Both the Free Church of Scotland ("wee frees") and the Free Presbyterian Church ("wee wee frees") take pride in having eschewed an amalgam between Scotland's main Protestant churches, achieved a century ago through a slight blurring of theological edges. But like many zealous groups, both Scotland's hardline Protestant sects have been wracked by squabbles, personal and theological. Ulster's Free Presbyterians (separate from the Scottish ones) avoided a split last year only after the resignation of their founder, the pastor-politician Ian Paisley.

Schisms and scandals have also raged among the Greek Orthodox clerics who quit their national church in the 1920s when it adopted the modern calendar. And for people who have seen the militant edges of Christianity in several places, there are psychological parallels, at least, between Orthodoxy's old-calendar holdouts and the ultra-Protestants. "Aesthetically, they are very different, but they are similar in their zeal and exclusivity," says Sofka Zinovieff, an Anglo-Russian writer who knows both Scotland and Greece.

Even for people professionally committed to Christian unity, such as Odair Pedroso Mateus, a Brazilian Protestant who watches church reunions for the WCC, there is a feeling that shoehorning religious groups together isn't always feasible or desirable. "Institutional reunion was a modern idea—perhaps in the post-modern era, we have to reconcile the existing diversity," he says.

Economist.com WORLD INTERNATIONAL

Islam and Christianity

Not merely academic

Oct 16th 2008 | CAMBRIDGE, ENGLAND
From The Economist print edition

In religion as well as diplomacy, jaw-jaw is better than war-war

IT'S a very long way from the cloisters of Cambridge to the Iraqi city of Mosul, where at least a dozen Christians have been killed this month, and hundreds of Christian families have fled, in that country's latest sectarian mayhem.

But Rowan Williams, head of the 80m-strong Anglican Communion, and Ali Gomaa, the grand mufti of Egypt, were doing their gallant best to minimise the distance as they presided, this week, over a new effort by the world's leading Muslim and Christian scholars to understand each other. The threat facing Iraqi Christians had "undermined a centuries-old tradition of local Muslims protecting and nourishing the Christian community", the two clerics carefully opined, as they pledged to create links between Western academia and Muslim universities, like Egypt's 400,000-strong al-Azhar campus, a place which had already been awarding degrees for two centuries when Cambridge was founded in 1209.

"Keep it cerebral" has been the watchword of a sort of strategic Muslim-Christian debate that was launched a year ago and is also bringing pundits together on American campuses such as Yale and Georgetown. Mustafa Ceric, Bosnia's grand mufti, came to Cambridge to remind fellow clerics that Islam, and Muslim scholarship, has deep roots in European history.

Mindful of the row he caused by saying *sharia* law had a future in Britain, the archbishop stressed some differences between the two faiths' ideas on love and sacrifice. All a little too academic? Worthy utterances in universities may not ease the woes of Christians in Iraq, but they do reduce the chances that somebody will say the wrong thing and make the situation worse: it was a university lecture by Pope Benedict XVI in 2006 that triggered anti-Christian violence in Muslim lands from Somalia to Turkey. Perhaps all participants in inter-faith discussions should observe the old doctors' maxim: "First, do no harm."

Economist.com BUSINESS

Industry and the financial crisis

Meanwhile, in the real economy...

Oct 16th 2008
From The Economist print edition

How the world's most basic industries are coping with the crash

Bloomberg

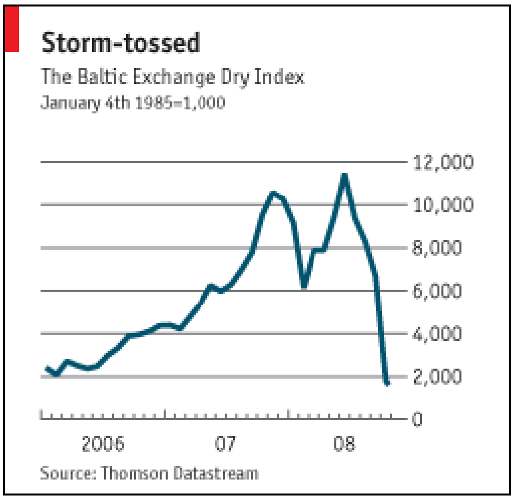
IT IS about as far as you can get from the woes of Wall Street and this week's dramatic rescues of American and European banks. The mucky business of digging ore out of the ground, shipping it across the oceans and turning it into steel, the feedstock of industry, is at the other end of the economic food chain from the trade in credit-default swaps, collateralised debt obligations and other esoteric financial instruments. So the recent fall in raw-material prices and the decline in shipping costs indicate just how far-reaching the consequences of the global financial crisis will be for the global economy.

Since the early summer the prices of various kinds of steel have fallen by 20-70%, iron ore is down by a third and the key rate for bulk shipping of commodities such as iron ore, coal and grain is down by more than four-fifths. There is even talk of grain cargoes piling up in ports in the Americas. Their buyers' letters of credit have not been honoured, because of a lack of confidence in the banks that underwrite them. At least one Australian producer has had the same problem with iron-ore shipments. And shipowners are struggling to finance new vessels they have ordered.

The most spectacular reflection of falling activity has been the Baltic Dry Index (BDI), which traces prices for shipping bulk cargoes such as iron ore around the world from producers such as Brazil and Australia to markets in America, Europe and China. The index has plunged 86% after hitting a record high of 11,793 points in late May (see chart). It fell by 11% on October 15th alone, to its lowest level since February 2003. The BDI is a leading indicator of international trade and, by extension, of economic activity. In the past couple of years the index has been driven up by the boom in China, as the world's fastest-growing big economy sucks in raw materials in bulk-carrying ships and pumps out finished products, which are exported in huge container vessels.

Some industry forecasters predict a recovery in the BDI of about 30% in the fourth quarter, but further weakening is foreseen in late 2009, extending into 2010. This is due both to the slowing

growth of world demand, and the arrival of new capacity following the recent boom in shipbuilding, which will cause supply to grow faster than demand. There are also signs of slowing growth in the market for the container ships that take China's manufactured goods to Western markets. The latest forecasts show growth in demand for container shipments from Asia to Europe falling from 15% a year to barely 5%. Shares in shipping companies fell sharply this week in response to the plunge in the BDI.



Steel prices have also been falling fast from record highs. In America the price of coil steel, used to make cars and white goods, has fallen by 20% since May. The price of steel billets, which are traded on the London Metal Exchange (though most steel deliveries are governed by inter-company contracts), has fallen even further, having tumbled by 70% since May.

As prices fall, steelmakers are moving to cut production. ArcelorMittal, the industry leader, was one of the first to move in September, signalling a cut of 10-15% in production during the third quarter. The company said the cuts were a temporary measure until inventories fell. Since then, however, Russian and Chinese steelmakers have also announced cuts. Severstal, Russia's biggest producer, is cutting by 25% in Russia and by 30% in some of its western European and American mills. China's biggest steelmaker, Baosteel, is reported to be reducing output by 10% this quarter, and the four second-tier producers (Shougang, Hebei, Anyang and Shandong) by 20%.

Shock and ore

Although China's iron-ore imports in the first nine months of the year were up 22% on 2007, there are fears among Australian mining firms that the cuts in Chinese steel production could presage a pause in China's boom. Mount Gibson, an Australian producer, has warned that stockpiles of ore are mounting up in China, and says some of its customers have asked it to delay shipments. Iron-ore prices on the spot market have fallen by roughly half since the beginning of the year, to $100 a tonne or less. The prices of copper, nickel and zinc have also fallen by around half this year, and aluminium is down by a third. Those drops, in turn, have battered the share prices of mining companies.

BHP Billiton and Rio Tinto, two giants that are big exporters of iron ore from Australia to China, agree that China's appetite for natural resources is moderating. But both say they are among the most efficient producers, and so will not be badly hit by falling demand. They do expect rivals with higher costs to rein in their output of iron ore and other minerals, however.

To some extent, that is already happening. Ferrexpo, a Ukrainian iron-ore producer, has said it will postpone a decision about whether to expand. Rio Tinto itself has reduced output at one of its Chinese aluminium mills; China's other smelters, it maintains, are in worse shape. Alcoa, a big American aluminium firm which reported a sharp fall in profits earlier this month, has shut a smelter in America and plans to halt investment on projects that are not near completion. Other firms have scrapped planned nickel and zinc mines. More of the same is likely the longer prices stay at this level—especially when hedges that protect some higher-cost producers expire.

Nonetheless, the bigger mining firms are far from despair. Alberto Calderon of BHP points out that the Baltic Dry Index is extremely volatile; in his view, it is not a good indicator of the long-term prospects of the mining industry. He expects the Chinese economy to keep growing by 6-9% a year for the next five years. Rio Tinto is even more sanguine: it does not foresee China's growth falling below 8%. Tom Albanese, its boss, says the Chinese economy is merely "pausing for breath".

Both firms point out that some metals, such as copper, are still in short supply, and that the credit crunch will only make it harder to finance new mines. By delaying expansion and squeezing marginal producers, it may actually sow the seeds for a recovery in metals prices sooner than most analysts expect. At any rate, BHP is determined to press ahead with its hostile bid for Rio Tinto—an indication, presumably, that it still thinks raw materials is a good business to be in.

Economist.com BUSINESS

GM and Chrysler

Follow the money

Oct 16th 2008
From The Economist print edition

Merging the two sickly car firms makes little sense—except for one thing

OBJECTIONABLE, but necessary. The description by Hank Paulson, America's treasury secretary, of the federal rescue package for America's banks, is a mantra that may soon be repeated in boardrooms across the land as recession-hit firms survey their dwindling options for survival. Few areas of the economy have been battered harder or for longer than the car industry, especially Detroit's Big Three. So the news which surfaced at the end of last week that General Motors (GM) and Cerberus Capital Management, the private-equity outfit that was paid $700m by Daimler to take Chrysler off its hands just 17 months ago, had been talking about a possible merger between the biggest and the smallest of the Big Three was a surprise, but hardly shocking.

GM and Chrysler have been on the critical list for months, as has Ford, which also recently had some short-lived preliminary discussions about a tie-up initiated by GM, its bigger (but sicklier) rival. All three firms were in the midst of far-reaching cost-cutting and restructuring plans when they were hit by surging oil prices and tightening credit. This hurt the carmakers in three ways. First came a catastrophic drop in demand for the gas-guzzling pickups and sport-utility vehicles that have accounted for most of Detroit's profits in recent years. Then came a collapse in earnings from leasing, as the residual values of fuel-thirsty vehicles plummeted. This was followed by the drying up of credit to fund new-car purchases. The carmakers' finance arms, usually good earners in bad times, have more or less shut up shop.

That Cerberus should be desperately seeking an exit from its ill-judged foray into the car business is understandable. The deal it has proposed to GM is said to involve swapping Chrysler for the 49% of GMAC (GM's lending arm) that Cerberus does not already own. Cerberus no doubt calculates that GMAC will be eligible for some of the government's bank-bail-out money and that its fortunes will eventually improve—whereas it probably sees no future of any kind for an independent Chrysler. It is rather harder to see what the attraction of absorbing Chrysler might be for GM ("merger" is a cruel euphemism).

GM already has too much of all the things Chrysler has to offer. It certainly does not need more brands, for example. With nearly a dozen of its own, GM already has too many for its shrinking market share. Although Cerberus might claim that Jeep still has resonance, the Chrysler and Dodge brands are damaged goods, worthless outside America. Nor does GM need more truck factories, when it is cutting its own capacity as fast as it can.

To make matters worse, notes Jim Hall, an industry consultant who used to work for GM, most of Chrysler's 3,500-strong dealer network would, under American law, have to be bought out at a total cost of well over $1 billion. And Chrysler does not have any compelling new models in the pipeline that might make it seem a more attractive proposition in the future. Having just launched (with almost hilariously bad timing) the new Dodge Ram pickup, Chrysler will have nothing fresh to sell until the small, Nissan-made Dodge Hornet arrives in 2010.

Meanwhile, Chrysler has announced that it is working on three electric vehicles, two of which will use similar range-extending technology to GM's keenly awaited plug-in hybrid, the Chevrolet Volt. But GM is a lot further down that particular road and Chrysler admits it only has the resources to apply the new powertrain to existing models. Cynics suggest that the main purpose of Chrysler's electric-vehicle programme is to allow it to snag its share of the $25 billion loan package agreed on by Congress last month to speed up the development of fuel-efficient cars.

A further consideration for GM is whether it really has the stomach for the opprobrium that is sure to come its way. Closing down much of Chrysler would enrage government, the unions, the dealers and the automotive-parts suppliers, all of whom GM depends upon. David Cole of the Centre for Automotive Research, an industry body, thinks it might just be worth it if the terms of the deal were right. "The trick is making it through the current period," he says. "But you have already taken out a lot of capacity and that is going to help restore pricing power in the industry for the first time in more than 10 years." Maybe,

but GM’s rivals would enjoy the same benefit while enjoying a free ride.

The real prize for GM might, however, be something much more tangible. In August Cerberus claimed that Chrysler still had $11 billion in cash from loans raised earlier. There is speculation that it might be willing to throw that in, and add some more, in exchange for a stake in the merged entity. GM, which is currently burning through more than $1 billion a month, had access to $21 billion in cash and $5 billion in credit at the end of June. Brian Johnson, an analyst at Barclays Capital, thinks that the carmaker needs a further $10.3 billion to get it through to the end of next year, when cost savings and recovering demand should start to kick in. As one of GM’s rivals observed this week: “We think it’s cash that’s driving this pony.”

European retailing

Shopped around

Oct 16th 2008 | PARIS
From The Economist print edition

Is Carrefour an example of activist investing gone wrong?

WHEN Carrefour, the world's second-biggest retailer, reports its third-quarter results on October 23rd, everyone will be looking to see how it did in the *rentrée scolaire*, the period when French families back from their holidays stock up on food and kit for their children going back to school. It is an important time for French retailers, and if Carrefour has done badly, its board may decide to fire its embattled chief executive, José Luis Durán—either right away or at the end of the year.

Bloomberg

Which way now?

Under Mr Durán, Carrefour has fallen short of analysts' expectations for the past three years. Its share price has fallen by 50% since the beginning of the year. In recent months it has been hit particularly hard as European shoppers have traded down to cheaper goods from discounters such as Aldi and Lidl, two German chains. Carrefour's French hypermarkets—which sell everything from food to televisions—are struggling against smaller supermarkets for groceries and specialist retailers such as IKEA or Fnac for other goods.

But some analysts question whether the retailer's poor performance is Mr Durán's fault. Carrefour's fundamental problem, they say, is that it has kept prices too high for too long, causing it to lose ground in France, Belgium, Poland and Turkey.

When Mr Durán took over in 2005, says Philippe Suchet, a retail analyst at Exane BNP Paribas in Paris, he launched an aggressive price-cutting campaign in order to regain market share—with some success. Then in 2007, when it became clear that Carrefour's founding Halley family would retreat from the firm, Bernard Arnault, the chairman of LVMH, a luxury-goods company, and Colony Capital, an American private-equity firm which specialises in property, stepped into the vacuum. They jointly bought a 9.8% stake through a holding company, Blue Capital, which became Carrefour's largest shareholder.

Soon afterwards, says Mr Suchet, Carrefour's pricing changed to become "merely competitive, rather than aggressive". This may have been because the activists were primarily interested in spinning off Carrefour's property assets, rather than regaining market share. They planned an initial public offering of its property arm. The proceeds would have been used to buy back Carrefour's shares, creating a large short-term gain for the shareholders, but the firm would have had to pay rent to the new company, thereby increasing its costs.

To pull this off, the shareholders needed Carrefour to maintain high profit margins in order to absorb the extra cost of rent, which meant keeping prices high. In the second quarter of 2008, as economic fears were mounting across Europe and discounters were seizing market share, Carrefour decided not to repeat a series of price promotions it had introduced in France in the same period in 2007. As a result, its

hypermarkets lost 60 basis points of market share. The property scheme has been shelved. The timing of Carrefour's pricing changes, says Mr Suchet, "seems to suggest that the new shareholders have had an influence on its price strategy."

Blue Capital denies this. "We never intervene in pricing at Carrefour as we consider that it is not the role of the board," says a spokesman for the holding company, which has lost an estimated €1 billion ($1.4 billion) on its investment so far. To be sure, Carrefour's problems began well before Blue Capital bought into the firm. And its property was poorly managed—something that has since improved, thanks to Colony's expertise in the field.

Will the board now allow Carrefour—under Mr Durán or a new boss—to slash prices to protect its long-term future? For the activists, a price war must be an alarming prospect. Cutting prices means an immediate drop in margins, and market-share gains could take years to materialise. But given the direction of consumer confidence, they may have little choice.

ZTE

Silent mode

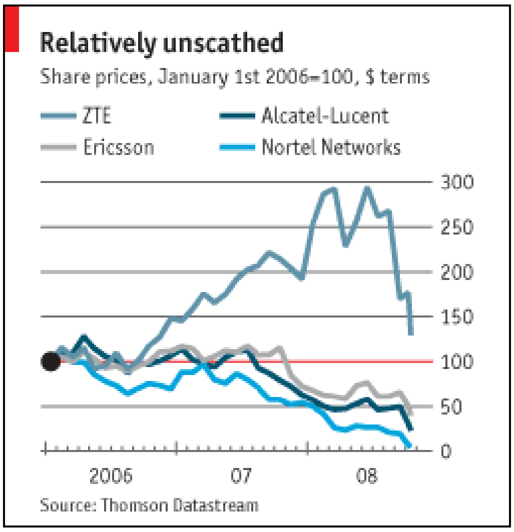
Oct 16th 2008 | SHENZHEN
From The Economist print edition

An emerging Chinese telecoms giant is growing steadily—and stealthily

IN THE last quarter of 2007 there were three new entrants in the top ten list of mobile-phone makers. Most people know two of them—Apple, maker of the iPhone, and Research in Motion (RIM), maker of the BlackBerry—but not the third: ZTE of China. Its worldwide market share went from 0.4% at the start of 2007 to 1.2% in the second quarter of 2008, according to Gartner, a consultancy. Last month it sold its 100 millionth phone. Its goal is to become the third-biggest handset-maker, behind Nokia and Samsung (it now lies in seventh place). Yet ZTE is easy to overlook, because of its distinctive business model.

Founded in 1985, ZTE chiefly makes networking gear, rather than phones. With prices for comparable products 25-90% less than those of its Western competitors, ZTE has customers in over 60 countries. As Alcatel-Lucent, Nortel and other established telecoms-equipment makers have suffered, ZTE has thrived. Its revenues and profits increased by more than 50% in 2007. This year growth is also likely to be strong, for two reasons.

Export sales, which account for around two-thirds of revenues, continue to grow as poor countries expand the range and capacity of their mobile-phone networks. On October 13th, for example, ZTE announced a $400m contract to provide equipment for a new network in India. At the same time ZTE (along with its domestic rival, Huawei), will benefit from one of the largest telecoms projects in history: the construction of China's much-delayed "third generation" (3G) mobile networks.



Behind ZTE's emergence are the usual factors that have come to be associated with China's economic rise, with a few twists. ZTE has benefited from the thousands of inexpensive and well-trained engineers coming out of China's universities, many of whom are deployed at short notice to work on large projects in some of the world's most difficult places. More fuzzy, but still important, has been ZTE's ability to use help from the Chinese government to arrange cheap financing for its global customers, which often lack capital.

Beyond these broader factors, ZTE has done a good job of understanding how to pursue a low-cost strategy—and there is far more to it than merely producing cheap products. "ZTE is a strong technology company, but of a particular sort," says James Liang, an analyst with Citigroup. ZTE focuses on making equipment that is cheap, reliable and unobtrusive.

In developed markets, makers of elaborate handsets such as Nokia, RIM and Apple have strong brands and fiercely loyal customers. This is a mixed blessing for network operators: offering a snazzy new handset can help them attract customers, but many users are more loyal to their handset-maker than to their operator. ZTE, by contrast, keeps itself in the background. It supplies handsets on a "white label" basis to operators, which then sell them under their own brands. The name ZTE is nowhere to be seen. In keeping with its roots as a network-equipment supplier, it sees operators, not consumers, as its customers.

ZTE moved into the handset market in 2002, and handsets accounted for 22% of its revenue last year; it expects this figure to reach 50% by 2012. ZTE does make some advanced handsets, but its strength is in combining low cost with a willingness to customise handsets for the operators. For Australia's Telstra, for example, it produced a "country phone", with a pull-out antenna, which suits people outside cities who need highly sensitive receivers. Although ZTE supplies phones to big names such as Vodafone and Telefónica, most of its customers are in the developing world, where overall handset sales are growing by

16% a year. ZTE’s steady but stealthy rise reflects how much of the growth in telecoms is at the bottom of the economic pyramid.

Yahoo!

Boo hoo!

Oct 16th 2008 | TOKYO
From The Economist print edition

More bad news for the struggling internet giant, this time from Japan

EVER since Yahoo! rejected Microsoft's offer of $31 a share in February, its fortunes have only worsened. Growth in internet advertising, Yahoo!'s main source of revenue, is slowing as the economy sours. An alliance with its main rival, Google, has been put on hold while antitrust regulators study the deal. Its share price has lately fallen below $13. The brightest treasure in Yahoo!'s empire has long been its Japanese arm, in which it has a 34% stake. It dominates its lucrative local market and reported increased revenue and profit on September 30th for the year to March. But even this jewel is losing its sparkle.

In September Yahoo! Japan admitted that its online-auction site had suffered a huge security breach. Over the summer it had been flooded with fraudulent login attempts using around 1.5m usernames. Having logged in, criminals used hijacked accounts to sell counterfeit luxury goods. The auction site is the country's biggest, with some 16m items listed at any time. It handled around ¥740 billion ($6.5 billion) of transactions last year.

More than 7m people pay Yahoo! Japan a monthly fee to use its services, including the auction site. In addition, the firm charges ¥10.5 for each item listed, plus a commission of 5.25% of the selling price. But when users started challenging the suspicious charges levied on fraudulent transactions and buyers complained about the fakes, the company initially insisted that there was no problem and users had to pay up. A certain amount of fraud is inevitable, so the firm did not notice at first that anything was amiss, explains Chizu Sasaki of Yahoo! Japan.

Last month the company acknowledged the problem and agreed to reimburse users who had been charged fees relating to fraudulent transactions. This set off a stampede of further complaints, as other users scrutinised their bills. Yahoo! Japan says it does not know how so many usernames were stolen, but suggests that they may have been leaked by another website. It feebly advised users to change their passwords.

The security breach is terrible news. Users may be less inclined to use a site they no longer trust to protect their personal details. And Yahoo! Japan faces other worries. Google is catching up, revenue growth is slowing and managers are defecting to rivals. Its share price has tumbled by 50% in the past six months.

Economist.com BUSINESS

Logistics in Africa

Network effects

Oct 16th 2008 | MOMBASA
From The Economist print edition

Connectivity and commitment pay dividends in African transport

ASIDE from a few niche industries such as cut flowers, which are air-freighted from Kenya and Ethiopia to auctions in the Netherlands, African trade has not changed much since the end of the colonial era. Unprocessed raw materials go out; finished goods come in. The trade imbalance is vividly illustrated by the ships sent from Asia to pick up empty containers left at African ports. Within Africa, moreover, it is difficult and costly to move goods. The continent has only a few broken-down railways. It has nothing resembling a transcontinental motorway. Even the British colonial dream of a road connecting Cape Town with Cairo failed.

Today, getting a container to the heart of Africa—from Douala in Cameroon to Bangassou in the Central African Republic, say—still means a wait of up to three weeks at the port on arrival; roadblocks, bribes, pot-holes and mud-drifts on the road along the way; malarial fevers, prostitutes and monkey-meat stews in the lorry cabin; hyenas and soldiers on the road at night. The costs of fuel and repairs make even the few arterial routes (beyond southern Africa) uneconomic. A study by America's trade department found that it cost more to ship a ton of wheat from Mombasa in Kenya to Kampala in Uganda than it did to ship it from Chicago to Mombasa.

But several companies are trying to make the best of Africa's creaking infrastructure to construct transcontinental logistics networks. Among them are DHL, Maersk, Dubai World and Chinese companies supplying oil and mining projects in Angola and the Democratic Republic of Congo (DRC). The clear leader so far is Bolloré Africa Logistics, a division of Bolloré, a French industrial conglomerate.

Bolloré's African adventure started in the 1980s when Vincent Bolloré, the omnivorous billionaire who heads the family firm, began to buy up ancient transport infrastructure in west Africa. Growth since has been rapid and mostly profitable. As a port operator, stevedore, warehouser and freight forwarder, Bolloré handles 80% of west Africa's exports (excluding oil) and 25% of east Africa's—in short, nearly all of Africa's cotton and cocoa, as well as much of its coffee, rubber, and timber.

With offices in 42 African countries and 20,000 of his 31,000 employees based in Africa, Mr Bolloré is bullish on the continent's prospects. Bolloré Africa Logistics accounts for $2 billion of the group's $10 billion annual revenues. Its head, Dominique Lafont, predicts 12-17% annual growth for the division for the next five years. He believes better logistics are vital to reduce poverty in Africa. A new warehouse for

perishable goods, or a new garage for repairing overland lorries, he reckons, create more lasting benefits to Africans than most aid projects do.

Bolloré's aim is to exploit the massive unrealised potential for trade between African countries by being the first to link the economies of the Francophone and English-speaking parts of Africa. It wants to do this by establishing a 26,000km (16,000 mile) pan-African network of "vital corridors", making use of whatever infrastructure is available, with long sections of transit by barge down the Niger, Congo, and Nile rivers deep into the interior.

Ports and "dry ports" (depots with customs-bonded warehouses) are probably the easiest part of Africa's logistics network to fix. Bolloré was among 100 firms, "15 of them serious", says Mr Lafont, to tender for the right to operate a new port outside Lagos in Nigeria. It already runs several other west African ports, hopes to be reconsidered for the Dar es Salaam port in Tanzania, and wants to compete with Dubai World's Djibouti port, which has a monopoly in the Horn of Africa, by developing the port of Berbera in former British Somaliland. Bolloré's biggest bet was on Abidjan port in Côte d'Ivoire, where it invested heavily despite a prolonged civil war, reducing the handling time of containers in the port from eight days to two.

Ivorian officials say Bolloré's investment, which allowed cocoa exports to continue during the fighting, helped keep the country from collapse. For its part, Bolloré brazenly uses Abidjan as part of its sales pitch of Afro-optimism and to illustrate its policy of never pulling out of any country. The firm claims to have continued operations through the Rwanda genocide, wars in Sudan and Congo, and during this year's election crisis in Kenya.

As African economies grow and demand for consumer goods increases, Bolloré expects to make more of its money from supply-chain contracts. In Kenya, for example, it has a contract with British American Tobacco to transport tobacco from farm to factory and then as finished cigarettes to smokers across east Africa. Bolloré expects to lose money on serving the remote ends of its "vital corridors", but believes maintaining the network will put it in a better position to bid for supplying lucrative projects such as iron ore mines in DRC, oil fields in Sudan, gold fields in Tanzania and gas pipelines in Nigeria.

The biggest impact of improved logistics in Africa may be on good governance. Prompt payment of customs dues by logistics companies on behalf of their clients and paperless transit have increased tax revenues and reduced government corruption. It is harder for a customs official to hold out for a bribe when the system is computerised and tracked by a logistics company's bar code—although not impossible: in grubbier ports, officials sometimes hold cargo to ransom by refusing to press the return key on the keyboard.

But if the logisticians are to make headway, African governments must also do their part. They need to reduce banditry, keep roads and bridges in better shape and regulate Africa's informal trucking business, run by cowboy operators who overload old lorries and pay bribes instead of taxes. Above all, Africa needs to smooth passage along its roads. Landlocked Rwanda recently identified 47 checkpoints and weighbridges between Mombasa and Kigali. Getting rid of roadblocks would cut the cost of shipments by 20%—and clear the way for broader economic growth.

Telecoms

Satellites? Are they nuts?

Oct 16th 2008
From The Economist print edition

A new satellite-broadband system hopes to succeed where others failed

MAKING a big, risky investment in these turbulent times might seem a bit daft. And investing in a satellite-broadband project sounds dafter still: billions were lost on similar projects during the 1990s. So why would investors in O3b Networks, a start-up based on the island of Jersey, put €500m ($680m) into another such system—and one which depends on finding customers in the world's poorest regions?

One reason is that O3b has been able to learn from the mistakes made by previous projects, such as Globalstar, Iridium and Teledesic. Over-ambitious, both commercially and technically, they set out to provide global coverage. This meant relying on unproven and complex technology and launching dozens of satellites into low-earth orbit. Although the survivors, Globalstar and Iridium, have long since refocused, they set out to sell their services mainly to consumers and businesses in rich countries.

O3b, by contrast, intends to offer bandwidth on a wholesale basis to internet-service providers, and transmission services to telecom operators, to link remote base stations to their core networks. Furthermore, O3b's service will be available only in a ribbon around the equator, covering most developing countries. It can start offering this service with just five satellites (it will eventually have 16) circling 8,000km above the equator. These should be in orbit by late 2010.

The goal of O3b's founder, Greg Wyler, is to provide remote areas in developing countries with cheaper high-speed internet access—something that he found too expensive during his tenure as the owner of Rwanda's national telephone company between 2004 and 2007. O3b (short for the "other three billion" who lack internet access) plans to charge $500 per megabit per month, compared with $4,000 using existing satellite systems. Claude Rousseau of Northern Sky Research, a consultancy, says there is lots of pent-up demand for broadband-internet access, particularly in Africa. Although several submarine cables are being laid to connect sub-Saharan Africa to the rest of the world, fast links do not reach into the interior.

So far Mr Wyler has raised €40m from three investors: Google, HSBC Principal Investments and Liberty Global, an international cable operator. They will probably have to fork out more, since O3b is unlikely to be able to finance the remainder with loans. And even if the service gets off the ground, telecoms operators may be reluctant to sign up, either because of regulatory issues or because they will see O3b as a competitor. Worse, they may not pass on the savings to their customers. O3b may well overcome the technical hurdles, but political and regulatory ones remain.

Face value

Hip-hope

Oct 16th 2008
From The Economist print edition

Can Russell Simmons promote entrepreneurship as well as he sells music, fashion and finance?

The Guardian

“THAT’S real hood,” says Russell “Rush” Simmons, with evident disapproval. He has just screened his company’s latest advertisement on his laptop, and is not inclined to approve it for release. The ad, for a Rush Visa pre-paid charge card aimed at people who do not have a bank account, featured only black people. “Aren’t there any white people who are poor in this country?” thunders Mr Simmons down the phone to the man who commissioned it. The ad is intended for the BET television channel, with a mainly African-American audience, but Mr Simmons says he does not want it to imply that black people are the only poor people in America, or, indeed, that the user is poor at all. “This card is meant to get people laid, get them feeling dignity,” he says.

Launched five years ago to provide America’s estimated 60m-70m unbanked consumers with a cheaper, more reliable alternative to payday cheque-cashers, the Black Rush card—along with its companion, the Pink Baby Phat card—has been thriving during the subprime crisis, which has driven more people out of mainstream financial services, says Mr Simmons. It is now poised to start making serious profits, he predicts—unless, that is, “Wal-Mart kills us” with its rival card. (There is a lively debate about which card offers better terms.)

Mr Simmons is not your typical financier, which may be why his business is growing even as the mainstream banking system melts down. Best known as the “godfather of hip-hop”, he made his first fortune as co-founder of Def Jam records, guiding the careers of artists such as Run DMC, the Beastie Boys, Public Enemy and Jay-Z. The company was sold to Universal Music for $100m. He made a second fortune in fashion, ultimately selling his Phat Farm “urban apparel” business (mantra: “Classic American Flava”) for $140m in 2004. His sprawling Rush conglomerate, headquartered on the 43rd floor of a Manhattan skyscraper and guarded by a huge but seemingly amiable bodyguard, also features jewellery (big diamonds a speciality), running shoes and energy drinks. Mr Simmons has just launched a new range of Argyle clothing, for “those guys who are not young men anymore, but who want to still be part of that urban lifestyle.”

He has done well enough to have had assets with Lehman Brothers in London that were frozen when the investment bank failed, leaving him “broke a bit, too”. His success has earned him a fabulous way of life and an almost permanent place in the gossip pages, which cannot get enough of his luxurious homes, his ascent in Manhattan society (he pals around with Donald Trump and George Soros, and has co-hosted parties on the *Forbes* yacht), or the unabashed bling of his ex-wife, Kimora, a former model. Although the couple have now separated, she remains the driving force behind the successful Baby Phat business.

Lately Mr Simmons has been increasingly focused on other aspects of life—daily yoga, and political campaigns against New York's fierce drug laws and for Barack Obama—and on his philanthropy, both personal and in business. He has long embraced cause-related marketing, committing to put a slice of profits to work on various social problems. Sometimes this has been controversial, such as his willingness to work with De Beers at a time when concern about "conflict diamonds" was at its height. He happily lost a lucrative deal with PepsiCo because of its stake in KFC (Mr Simmons, a member of PETA, is appalled by the chain's treatment of chickens). He contrasts his business philosophy with that of his friend, Mr Trump: "I believe what you sell should have a lasting happiness to it—unlike Donald, who believes you sell people whatever they want."

In his personal philanthropy, Mr Simmons supports arts programs for underprivileged children, education in South Africa and efforts to promote religious tolerance, as well as various good causes through his Hip-Hop Summit Action Network. It has recently taken up the challenge of promoting financial literacy to the young hip-hop fans who attend its events. Mr Simmons describes this as "a bunch of rappers and Suze Orman" (a popular financial adviser), with stars such as Doug E. Fresh literally leading fans page by page through a financial-literacy textbook.

Phat and happy

Mr Simmons is increasingly presenting himself as a role model for young entrepreneurs, especially African-Americans. Last year he published a bestselling book, "Do You! 12 Laws to Access the Power in You to Achieve Happiness and Success." (It contains "the same shit you get in any other book—a little bit mystical, but really about going to work every day and keeping your head down," he says.) He recently visited the New York Stock Exchange to launch Race to BE, a prize for young entrepreneurs in fashion, film and music which will be presented during the first Global Entrepreneurship Week (November 17th-23rd).

Entrepreneurship, according to Mr Simmons, is consistent with hip-hop, which is "all about believing in your vision". It is much more a part of the African-American culture than when he started out as a promoter of rappers, he recalls. Back then there were few role models. Those, like him, who succeeded were "all hustlers, who learnt their entrepreneurship on the street." Now he gives speeches about entrepreneurship at colleges.

Mr Simmons did not complete college, in which respect, he notes, "I am just like Bill Gates". Yet he urges today's youngsters to get educated. This is excellent advice, probably far more useful to most of his fans than encouraging them to be entrepreneurs, desirable though that is. Dropping out of school seems to be a common feature of many an entrepreneur's life story, yet the truth is that succeeding as an entrepreneur is a lot harder than making a decent living with a college education. Admirably, Mr Simmons urges aspiring entrepreneurs to be authentic ("Do You"). But few of his fans are likely to have the instinctive gift for creating successful brands that has made Doing Him so lucrative.

A short history of modern finance

Link by link

Oct 16th 2008
From The Economist print edition

The crash has been blamed on cheap money, Asian savings and greedy bankers. For many people, deregulation is the prime suspect

Illustration by Brett Ryder

THE autumn of 2008 marks the end of an era. After a generation of standing ever further back from the business of finance, governments have been forced to step in to rescue banking systems and the markets. In America, the bulwark of free enterprise, and in Britain, the pioneer of privatisation, financial firms have had to accept rescue and part-ownership by the state. As well as partial nationalisation, the price will doubtless be stricter regulation of the financial industry. To invert Karl Marx, investment bankers may have nothing to gain but their chains.

The idea that the markets have ever been completely unregulated is a myth: just ask any firm that has to deal with the Securities and Exchange Commission (SEC) in America or its British equivalent, the Financial Services Authority (FSA). And cheap money and Asian savings also played a starring role in the credit boom. But the intellectual tide of the past 30 years has unquestionably been in favour of the primacy of markets and against regulation. Why was that so?

Each step on the long deregulatory road seemed wise at the time and was usually the answer to some flaw in the system. The Anglo-Saxon economies may have led the way but continental Europe and Japan eventually followed (after a lot of grumbling) in their path.

It all began with floating currencies. In 1971 Richard Nixon sought to solve the mounting crisis of a large trade deficit and a costly war in Vietnam by suspending the dollar’s convertibility into gold. In effect, that put an end to the Bretton Woods system of fixed exchange rates which had been created at the end of the second world war. Under Bretton Woods, capital could not flow freely from one country to another because of exchange controls. As one example, Britons heading abroad on their annual holidays in the late 1960s could take just £50 (then $120) with them. Investing abroad was expensive, so pension funds kept their money at home.

Once currencies could float, the world changed. Companies with costs in one currency and revenues in another needed to hedge exchange-rate risk. In 1972 a former lawyer named Leo Melamed was clever enough to see a business in this and launched currency futures on the Chicago Mercantile Exchange. Futures in commodities had existed for more than a century, enabling farmers to insure themselves against lower crop prices. But Mr Melamed saw that financial futures would one day be far larger than the commodities market. Today’s complex derivatives are direct descendants of those early currency trades.

Perhaps it was no coincidence that Chicago was also the centre of free-market economics. Led by Milton Friedman, its professors argued that Keynesian economics, with its emphasis on government intervention, had failed and that markets would be better at allocating capital than bureaucrats. After the economic turmoil of the 1970s, the Chicago school found a willing audience in Ronald Reagan and Margaret Thatcher, who were elected at the turn of the decade. The duo believed that freer markets would bring economic gains and that they would solidify popular support for the conservative cause. A nation of property-owners would be resistant to higher taxes and to left-wing attacks on business. Liberalised markets made it easier for homebuyers to get mortgages as credit controls were abandoned and more lenders entered the home-loan market.

Another consequence of a system of floating exchange rates was that capital controls were not strictly necessary. Continental European governments still feared the destabilising effect of hot money flows and created the European Monetary System in response. But Reagan and Mrs (now Lady) Thatcher took the plunge and abolished controls. The initial effects were mixed, with sharp appreciations of the dollar and pound causing problems for the two countries' exporters and exacerbating the recession of the early 1980s.

But the result was that institutions, such as insurance companies and pension funds, could move money across borders. In Britain that presented a challenge to the stockbrokers and marketmakers (known as jobbers) who had controlled share trading. Big investors complained that the brokers charged too much under an anti-competitive system of fixed commissions. At the same time, big international fund-managers found that the tiny jobbing firms had too little capital to handle their trades.

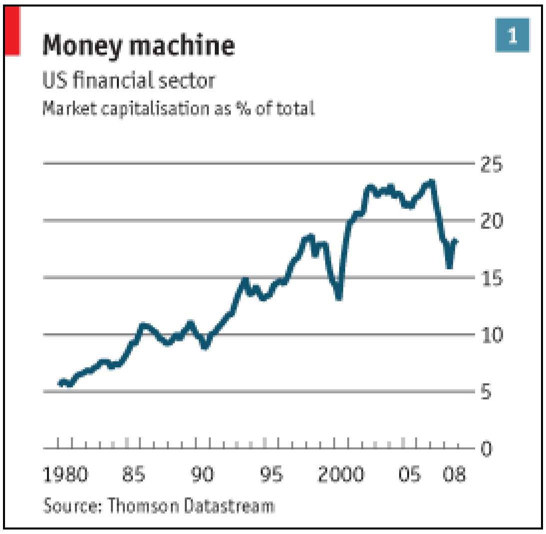
The Big Bang of 1986 abolished the distinction between brokers and jobbers and allowed foreign firms, with more capital, into the market. These firms could deal more cheaply and in greater size. New York had introduced a similar reform in 1975; in America's more developed domestic market, institutional investors had had the clout to demand the change long before their British counterparts.

These reforms had further consequences. By slashing commissions, they contributed to the long-term decline of broking as a source of revenue. The effect was disguised for a while by a higher volume of transactions. But the broker-dealers increasingly had to commit their own capital to deals. In turn, this made trading on their own account a potentially attractive source of revenue.

Over time, that changed the structure of the industry. Investment (or merchant) banks had traditionally been slim businesses, living off the wits of their employees and their ability to earn fees from advice. But the need for capital led them either to abandon their partnership structure and raise money on the stockmarket or to join up with commercial banks. In turn, that required the dilution and eventually, in 1999, the abolition of the old Glass-Steagall act, devised in the Depression to separate American commercial and investment banking.

Commercial banks were keen to move the other way. The plain business of corporate lending was highly competitive and retail banking required expensive branch networks. But strong balance-sheets gave commercial banks the chance to muscle investment banks out of the underwriting of securities. Investment banks responded by getting bigger.

Expansion and diversification took place against a remarkably favourable background. After the Federal Reserve, then chaired by Paul Volcker, broke the back of inflation in the early 1980s, asset prices (property, bonds, shares) rose for much of the next two decades. Trading in, or lending against, such assets was very profitable. And during the "Great Moderation" recessions were short, limiting the damage done to banks' balance-sheets by bad debts. As the financial industry prospered, its share of the American stockmarket climbed from 5.2% in 1980 to 23.5% last year (see chart 1).



Risky business

As banks' businesses became broader, they also became more complex. With the help of academics, financiers started to unpick the various components of risk and trade them separately.

Again, Chicago played its part. Option contracts were known in ancient history but the 1970s saw an explosion in their use. Two academics who had studied, or taught, at the University of Chicago, Fischer Black and Myron Scholes, developed a theory of option pricing. And the Chicago Board Options Exchange was set up in 1973 as a forum for trading.

Whereas futures contracts lock in the participants to buy or sell an asset, an option is more like insurance. The buyer pays a premium for the right to exercise his option should prices move in a set direction. If prices do not move that way, the option lapses and the buyer only loses the premium. The Black-Scholes formula shows that an option's value depends on the volatility of the underlying assets. The more the price moves, the more likely the option is to be exercised. Calculating that volatility was made a lot easier by the growing power of computers.

The next great development in risk management was the swap. Bond markets had been domestic, with buyers focusing on issuers from their home markets. That created the potential for arbitrage, issuing bonds in one currency and swapping them for another, creating lower interest rates for both borrowers.

It was a short step from currency swaps to interest-rate swaps. Borrowers on floating (variable) rates could swap with those on a fixed rate. This allowed company finance directors (and speculators) to change their risk exposure depending on their view of where rates would go. Rather than pay each other's interest costs directly, the payments would be netted out.

The final stage emerged only in the past decade. A credit-default swap (CDS) allows investors to separate the risk of interest-rate movements from the risk that a borrower will not repay. For a premium, one party to a CDS can insure against default. From almost nothing just a few years ago, CDSs grew at an explosive rate until recently (see chart 2).

Futures, options and swaps all have the same characteristic: a small initial position can lead to a much larger exposure. Futures contracts are bought with only a small deposit or margin; option sellers have to cover buyers' losses, which may be many times the value of the premium; the net exposure of a swap counterparty may be smaller but the gross position will be huge, a problem if the counterparty defaults.

This made it hard for regulators to keep track of a firm's exposure. For years, therefore, they concentrated on improving the infrastructure of the market, making sure that deals were well documented or settled through a central clearing house (something yet to be achieved for CDSs).

The biggest hiccup in the growth of the derivatives markets came after the 1987 stockmarket crash, when a technique known as portfolio insurance took a lot of the blame. This involved investors selling stock-index futures to protect themselves from falls in the value of their portfolios. The problem was that the two markets acted on each other; as the futures price fell, so did the cash value of shares, forcing institutions to sell more futures and so on. That prompted the American authorities to introduce "circuit breakers", limiting the use of portfolio insurance at difficult times.

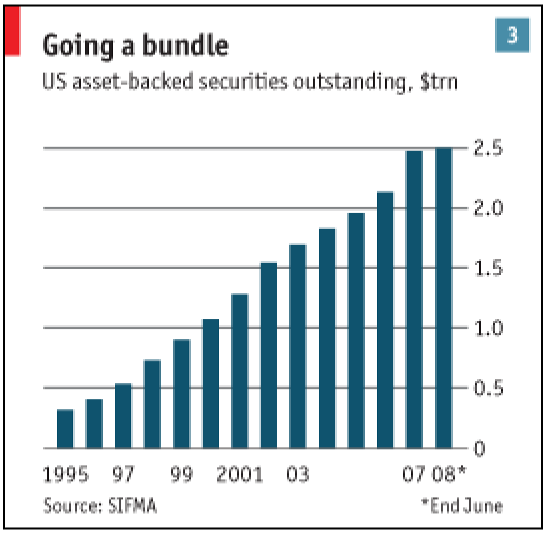
Derivatives caused more embarrassment in the 1990s as naive local authorities, such as Orange County in California, and corporate treasury departments lost fortunes in contracts they did not understand. But gradually the authorities learnt to love these markets; Frankfurt, for example, competed hard to win trading in German government-bond futures away from London. The theory was that, by allowing business and investors to spread risk, both markets and economies would become more robust.

Alan Greenspan, the chairman of the Fed from 1987 to 2006, was in the vanguard of this view. In his book, "The Age of Turbulence" (2007), he welcomed the growth of CDSs, arguing: "Being able to profit from the loan transaction but transfer credit risk is a boon to banks and other financial intermediaries which, in order to make an adequate rate of return on equity, have to heavily leverage their balance sheets by accepting deposit obligations and/or incurring debt. A market vehicle for transferring risk away from these highly leveraged loan originators can be critical for economic stability, especially in a global environment."

Securitisation, which has been at the centre of the current crisis, is another child of the 1970s. It involves bundling loans into packages that are then sold to outside investors. The first big market was for American mortgages. When homeowners pay their monthly payments, these are collected by the servicing agent and passed through to investors as interest payments on their bonds.

Again, this business was encouraged by the authorities as a means of spreading risk. Everybody appeared to win. Banks earned fees for originating loans without the burden of holding them on their balance-sheets (which would have restricted their ability to lend to others). Investors got assets that yielded more than government bonds and represented claims on a diversified group of borrowers. No wonder securitisation grew so fast (see chart 3).

These asset-backed securities became ever more complex. Securitisation eventually gave rise to collateralised debt obligations, sophisticated instruments that bundled together packages of different bonds and then sliced them into tranches according to investors' appetite for risk. The opacity of these products has caused no end of trouble in the past 18 months.



More fundamentally, securitisation opened a new route to growth for banks. No longer were commercial banks dependent on the slow, costly business of attracting retail deposits. Securitisation allowed them to borrow in the markets. Few imagined that the markets would not be open at all times. In 2007 Northern Rock, a British mortgage lender, was the first spectacular casualty of this false assumption; many more banks have been caught out in 2008.

Asleep at the wheel?

While all this was happening, regulators were not wholly passive. They had to deal with crises such as the failures of Drexel Burnham Lambert, which dominated the junk-bond market, and Baring Brothers, a British bank brought low by a rogue trader. But these were regarded as individual instances of mismanagement or fraud, rather than as evidence of a systemic problem. Even the American savings-and-loan crisis, an early deregulation disaster, was tidied up with the help of a bail-out plan and easy monetary policy, and dismissed as an aberration.

Rather than question the principle of deregulation, some governments redesigned their regulatory structures. Britain devised the FSA in 1997 (even taking away banking regulation from the Bank of England) in a conscious attempt to create a single supervisory body. In America the SEC shares authority with the Commodities Futures Trading Commission, the Federal Deposit Insurance Corporation, state insurance commissioners and so on.

The authorities did make a more fundamental attempt to regulate the banks with the Basel accord. The first version of this, in 1988, established minimum capital standards. Banks have always been a weak link in the financial system because of the mismatch between their assets and liabilities. The assets are usually long-term loans to companies and consumers. The liabilities are deposits by consumers and investors that can be withdrawn overnight. A bank run is hard to resist, since a bank cannot realise its assets quickly; worse still, doing so—by calling in loans—may cause economic havoc by prompting bankruptcies and job losses.

The Basel accord was designed to deal with a different problem: that big borrowers might default. It required banks to set aside capital against such contingencies. Because this is expensive, banks looked for ways around the rules by shifting assets off their balance-sheets. Securitisation was one method. The structured investment vehicles that held many subprime-mortgage assets were another. And a third was to cut the risk of borrowers defaulting, using CDSs with insurers like American International Group. When the markets collapsed, these assets threatened to come back onto the balance-sheets, a prime cause of today's problems.

Illustration by Brett Ryder

It would be a mistake to argue that, had politicians rather than bankers been in charge, policy would have been more prudent. Indeed, politicians encouraged banks to make riskier loans. This was particularly true in America, where a series of measures,

starting with the Community Reinvestment Act of 1977, required banks to meet the credit needs of the “entire community”. In practice, this was social policy: it meant more lending to poor people. Fannie Mae and Freddie Mac, the two government-sponsored giants of the mortgage market, were encouraged to guarantee a wider range of loans in the 1990s.

The share of Americans who owned their homes rose steadily. But more buyers meant higher prices, making loans even less affordable to the poor and requiring even slacker lending standards. The seeds of the subprime crisis were sown, and the new techniques of securitisation allowed banks to make these loans and then offload them quickly.

Initially, the growth of homeownership was seen as a benign effect of deregulation, as was the ability of consumers to borrow on their credit cards, a habit they took to enthusiastically. The authorities largely welcomed this boost to consumer demand. In the 1970s and 1980s, they might have worried about the effect on inflation or the trade deficit. But technological change in the 1990s, and the impact of China and India in the 2000s, kept headline inflation down, while liberalised capital markets and Asian savings made external deficits easy to finance.

In addition, those countries with big financial centres were delighted to have them because of the tax revenues they yielded. That hardly encouraged them to look too closely at the financial industry. Nor did it hurt that political parties in both America and Britain received a lot of contributions from financiers.

Liberalisation happened for many reasons. Often, regulators were simply trying to catch up with the real world—for instance, the rapid development of offshore markets. In addition, deregulation provided things that voters wanted, such as cheap loans. Each financial innovation that came along became the object of speculation that was fuelled by cheap money. Bankers and traders were always one step ahead of the regulators. That is a lesson the latter will have to learn next time.

Amid the crisis of 2008, it is easy to forget that liberalisation had good consequences as well: by making it easier for households and businesses to get credit, deregulation contributed to economic growth. Deregulation may not have been the main cause of the rise in living standards over the last 30 years, but it helped more than it harmed. Will the new, regulated world be as benign?

Rescuing the banks

But will it work?

Oct 16th 2008
From The Economist print edition

Meltdown may have been averted. But the crunch is not over

Illustration by S. Kambayashi

THE global banking system has leapt from the fire into the frying-pan. After yet another burst of dramatic interventions, governments are now furiously tackling the twin problems afflicting banks—solvency and liquidity. Their actions briefly pepped up stockmarkets, and, more importantly, stabilised credit markets. But on October 15th and 16th stockmarkets tumbled headlong once again amid concerns that the banks had been rescued too late to stop a slump in the world economy.

For now, at least, a collapse in the banking system has been averted. On October 14th the American government held its nose and announced plans to invest $250 billion of taxpayers' money into its banks, half of that into a group of nine of the industry's most celebrated names. Smaller banks have until the middle of next month to apply for a share of the remaining $125 billion. More importantly for confidence, it also extended a sovereign guarantee for new bank debt and once again expanded the terms of its deposit guarantees.

The American moves followed a rare burst of European decisiveness. On October 12th euro-area leaders committed themselves to the same potent mix of debt guarantees and recapitalisation that Britain had unveiled, to much acclaim, the previous week. Governments are not stinting. Germany has set up a €500 billion ($680 billion) stabilisation fund; France has pledged €360 billion; the Netherlands €200 billion. UBS, the Swiss bank, will receive SFr6 billion ($5.2 billion) of state capital to help it shed toxic assets.

Britain itself has wasted no time in putting its cash to work, committing £37 billion ($64 billion) on October 13th to recapitalise its big banks. If ordinary shareholders do not take up their rights to new shares, the government could end up owning a majority stake in Royal Bank of Scotland and close to that in a merged Lloyds TSB-HBOS. Central banks are also spraying money around more liberally than ever. On October 15th the Federal Reserve, the European Central Bank and the Swiss National Bank made available unlimited dollar loans. The Bank of Japan plans to offer unlimited dollar funds from October 21st on.

Asian governments are also scrambling to shore up confidence. Australia and New Zealand have abandoned their purist stances on deposit insurance—they now have some. After slowly peeling back guarantees put in place during the Asian financial crisis a decade ago, Indonesia has expanded its deposit-insurance programme. Hong Kong has moved to full deposit insurance. South Korea will allow greater investment (up to 10%) by the country's big industrial groups in its banks, but its currency tumbled on October 16th after Standard & Poor's, a rating agency, said the banks may fail to refinance their debts.

The money markets took a measured view of all this action, but there were signs of improvement. The London Interbank Offered Rate (LIBOR) for three-month dollar loans fell for the third consecutive day on October 15th. Borrowing costs remain very high by historic standards, but the risk that banks will be unable to roll over their short-term funding has receded now that governments are, in effect, acting as counterparties. Credit-default swap (CDS) spreads on banks, a measure of their risk of bankruptcy, have tumbled (see chart).

Saving the banks from collapse is not the same as stopping a credit crunch, however. There is much to resolve before credit is flowing normally through the system. First, funding costs are likely to remain high. Investors' nerves are shot. The "Ted spread", the gap between three-month dollar LIBOR and the Treasury-bill rate, and a good indicator of risk aversion, stood at 4.2% on October 15th; it hovered at just 20 basis points (a fifth of a percentage point) in early 2007. Concern about banks' creditworthiness may yet morph into worry about sovereign risk as the full cost of the various bail-outs becomes clearer, especially if governments decide they also need to boost their economies with a fiscal stimulus. The approach of the calendar year-end, when banks need extra cash to help balance their books, will add to funding strains over the coming weeks.

The costs mount

Governments' debt guarantees are not free for the banks either. Many of them are rather expensive. Britain is charging 50 basis points plus the median CDS spread for a borrowing bank over the past 12 months. Germany is charging a flat rate of two percentage points. Some observers have expressed surprise that a fee is being levied at all. Despite government pleas that the banks get on with lending, officials may have worried about a splurge in debt issuance if the guarantees had been free. Further cuts in interest rates may help to bring down the cost of credit (and to bolster banks' earnings by steepening the yield curve, the difference between short- and long-term interest rates). But in the meantime dearer borrowing is bound to have a continuing impact on the spending plans of companies and consumers.

The second reason why credit is likely to remain gummed up is that banks still have reasons to husband capital. The injection of government money into American and British banks has set a new benchmark for capital ratios that banks elsewhere may now be judged by. Analysts at Keefe, Bruyette & Woods, an investment bank, reckon that other European banks would have to raise €70 billion-130 billion to match British levels. That is a disincentive to go on a lending spree.

So little time, so much to fear

In Britain and America, too, there are lots of reasons for caution. Banks remain weighed down by the same toxic assets that sparked this whole mess. The Americans still insist that they will dip into their $700 billion bail-out pot to buy up impaired assets, but the new capital injections will deplete their firepower. Accounting standard-setters have been arm-twisted into relaxing rules that force banks to mark certain assets to market, but in the long run that may hurt confidence in the health of bank balance-sheets, not help it. Bo Lundgren, one of the architects of Sweden's much-vaunted 1990s bank bail-out, stresses the importance of transparent valuations of bad assets.

In another difference with Sweden, where the economy had already been contracting for seven quarters before the government strongly intervened, the downturn in this economic cycle is still young. That means banks will suffer a new set of credit losses in coming months in areas such as credit cards, car loans and commercial property. Stresses in housing markets impose another constraint on lending: that may be why Sheila Bair, head of the Federal Deposit Insurance Corporation, an American bank regulator, broke ranks with her government and criticised the rescue plan for not addressing foreclosures. Banks may suffer from a crisis of confidence in emerging markets, too.

Companies are perhaps the biggest concern of all, even though firms have borrowed less than consumers. Default rates remain low but are bound to climb as the economy worsens. This wave of corporate failures will add further stress to the battered CDS market. And, as governments focus their efforts on bailing out the banks, non-bank sources of financing are becoming more fragile. The costs of issuing commercial

paper, a form of short-term debt heavily used by companies in America, will fall once a Fed facility for purchasing commercial paper is up and running on October 27th. Even so companies may well have to draw on uncommitted credit facilities with banks, expanding the size of bank balance-sheets.

“The idea that there will be a reboot of lending is not credible,” says George Magnus, an economist at UBS. Financial calamity may have been averted, but the world economy is still cooking up something very nasty.

The American economy

A spent force

Oct 16th 2008 | WASHINGTON, DC
From The Economist print edition

Ominous signs that the crisis will have a big impact on spending

IT WAS, admitted Hank Paulson as he threw a $250 billion lifeline to American banks, objectionable to most Americans, himself included, to see the government owning stakes in private companies.

He had no real alternative. But it would have been less objectionable had he been able to promise that the economy would escape a recession as a result. He could not. It may well be in recession already.

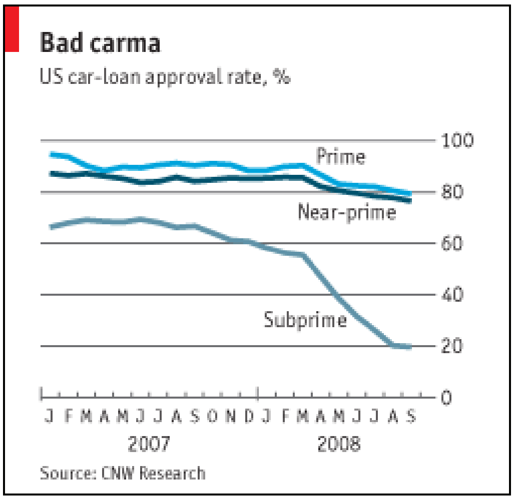
The economy appears to have barely grown in the third quarter and the surge in financial stress that followed Lehman Brothers' failure in mid-September will make things worse. The subsequent plunge in stocks on top of still-falling home prices could result in a 14% drop in household wealth this quarter, the largest on record, according to ISI Group, a broker. News that retail sales sank 1.2% in September triggered the biggest drop in the Dow industrials in 21 years on October 15th.

If it were only wealth, construction and other tangible factors that were in decline, the recession could still be on the mild side—especially as oil prices are falling. But the credit crunch is a wild card. The experience of the Carter era suggests the effect of credit restraint can be large. In 1980 President Jimmy Carter imposed credit controls in a ham-fisted effort to reduce inflation: banks that exceeded targets for some types of loans such as for consumer purchases and mergers had to set aside extra reserves. Americans overreacted in a burst of patriotic fervour; credit usage plunged and GDP fell by an annualised 8%, the steepest quarterly drop in the past 50 years.

Since then the influence of debt has probably grown as the economy has become more credit-intensive. Consumer and home-equity loans equalled 26% of annual personal consumption in the 1990s; they recently reached 36%. In the 1980s about half of homeowners had a mortgage; now about two-thirds do, says Ivy Zelman, a housing consultant.

Meanwhile, the demand for bank credit by companies shut out of the commercial-paper market is straining balance-sheet capacity. In theory the government's $250 billion rescue package for banks, levered ten-to-one, could support $2.5 trillion of lending (total credit in the economy was $27 trillion as of June 30th). But no one expects so large an effect because banks are trying to delever and will probably build their reserves in anticipation of more loan losses as the economy worsens.

Non-banks are a particular problem. The finance affiliates of the big carmakers, most prominently GMAC, 49% owned by General Motors, now face funding constraints, forcing them to raise underwriting standards and loan charges. Approvals for car-loan applications have fallen sharply (see chart).



Non-banks can tap the Federal Reserve's new commercial-paper guarantee programme, but are not eligible for government capital. Credit-card debt continues to grow but in that business, too, lenders are cracking down in subtle ways, says David Robertson of the *Nilson Report*, an industry newsletter. One is to reduce unused credit limits on middle-to-higher-income borrowers who might use more credit if they lose their jobs.

Surprisingly, mortgage-lending conditions may be improving. Under pressure from the federal government, Fannie Mae and Freddie Mac, the now-nationalised mortgage agencies, and the Federal Housing Administration, the programme for low-income buyers, are stepping up their activity. A buyer can now obtain an FHA loan with as little as 3.5% down on a house costing up to $625,000—which would include most of the homes in the country. Ms Zelman reckons the FHA accounted for 22% of mortgage

originations in the third quarter, up from 5% in all of 2007.

The real problem, Ms Zelman says, is that almost a quarter of homeowners with mortgages have zero or negative equity in their homes. Householders, she says, have too much debt and must save more. It is, she says, not about credit. “It’s about a hangover from hell.”

Wall Street, the sequel

Greed is gone

Oct 16th 2008 | NEW YORK
From The Economist print edition

But what will Gordon Gekko be like when he is back?

MASTERS of the universe one year, minions of the state the next, Wall Street's finest have been humbled as never before. Such a parable would be ideal fodder for the recession-era moviegoer. As it happens, 20th Century Fox is already working on a sequel to the 1987 classic, "Wall Street", with Michael Douglas mulling a reprise of his Oscar-winning role as Gordon Gekko, the predator-in-chief of the junk-bond boom.

The script is in the hands of Allan Loeb, a former Chicago Board of Trade broker. Expected to draw on recent events, it follows Mr Gekko's exploits after leaving prison. If he is to be cast once again as a villain, the mind boggles at the possibilities. A mortgage broker? The genius behind collateralised-debt obligations? Dick Fuld? A naked short-seller? (Steady, ladies.) The Gekko character was said to be a blend of notorious moneymen, including Ivan Boesky, an insider trader, and Carl Icahn, an activist investor who is still bothering companies he considers poorly managed.

The obvious twist this time would be to cast the braces-clad slicker as a hero. He could return in the same role, as a corporate raider who launches proxy attacks to clean up the bombed-out banks. One blogger has already suggested a tale that ends with Mr Gekko leading markets out of their slump, noting that the Dow rose 936 points on the day news of the sequel broke.

But he would need a new vocabulary. His era-defining catchphrase in the original, "Greed is good" (a misquote: it was actually "Greed—for lack of a better word—is good"), jars in these harsh times. "Greed—provided it is sufficiently regulated—is tolerable" might be more appropriate now. The studio might also want to rethink the working title, "Money Never Sleeps"; just now many people's money is under the mattress. Given rising anxiety that America has replaced red-blooded capitalism with French-style dirigisme, how about "*La rue du Mur*"?

The legacy of depression

L-shaped poverty lines

Oct 16th 2008 | TOKYO
From The Economist print edition

Japan shows how long the impact of a bust can linger for ordinary people

“IT IS tough,” says Kiyoshi. As the plume of cigarette smoke dissipates, his smile exposes a single tooth. At 65, he has been homeless for six years, sleeping amid possibly hundreds of others in Ueno Park in Tokyo. At weekends they emerge from their blue tarpaulin tents (with shoes neatly placed in front, as is the Japanese custom) and queue for soup and rice.

Like many of Japan’s homeless, Kiyoshi lived a normal life during Japan’s boom years, working in a restaurant. But life became hard in the 1990s after the property and stockmarket bubble burst. He now collects empty aluminium cans to earn—“on a good day”—around ¥1,000 ($10) for food.

Whether or not the West has been saved from “depression” by the co-ordinated banking rescues of its governments, the possibility remains of a sharp economic recession around the world. Economists debate whether this recession might be “V-shaped” (ie, brief) or “L-shaped” (prolonged). People like Kiyoshi put a face to what is at stake—and the lasting impact it can have on everyday life.

Japan’s experience counts because its own credit crisis mirrors parts of what is happening elsewhere today. In the early 1990s loose lending was followed by a collapse in property and share prices, almost burying banks under mounds of non-performing loans. (Among the dissimilarities are that banks and regulators reacted slowly and hid the extent of the troubles longer than they have this time.) By 1997, seven years into the crisis, many large banks had started going bust. The government spent more than $400 billion on a bail-out (of which 70% has so far been repaid). The economy began to rebound in 2003.

The “lost decade” irrevocably changed Japan. At the start of the crisis in 1990 it was one of the most egalitarian rich nations on earth. But income inequality increased more than twice as fast as it did in America and Europe; today Japan is above the OECD average. Relative poverty is higher than in many rich countries. Long one of the safest societies in the world, street crime began to matter. Many full-time jobs were filled by cheaper, short-term and part-time workers. They do not pay pension contributions, storing up problems for the future.

Bloomberg

Still in the soup

Moreover, homelessness became a problem. Relative to most countries, Japan has few people living on the street. But the shanty towns that mushroomed in public parks and on the banks of rivers shocked a society in which homelessness almost never existed. For example, the government only started counting the number of homeless in 2003, tallying 25,000 people. Today, the official number is 16,000—which is believed to be far too conservative. The average age is 57; around 16% have been homeless for more than a decade. On October 3rd the Supreme Court ruled that a park cannot be used as an address—all but preventing the homeless from obtaining public medical treatment, applying for a job or voting.

The government's response was to spend. It forked out about ¥120 trillion between 1992 and 1999, mostly on useless construction projects in the hard-hit hinterland. It acted as a form of welfare. But in temporarily alleviating one problem, it created other, longer-term ones. The gross national debt soared to 180% of GDP—three times more than America's and the largest within the OECD.

The Bank of Japan kept interest rates at zero for nearly six years. Since February 2007 they have stayed at 0.5%. This acts as a subsidy from individuals (who earn almost nothing from their massive savings) to banks. But raising rates would increase the government's debt obligations.

Japan shows how long it can take to recover from financial collapse. Its stock prices did not hit bottom until 2003, more than a decade after they first started falling. They are still one quarter of their level at the peak. Property prices remain two-thirds below their highest level.

Even as things gradually improve, people like Kiyoshi may be left behind. Under the awning of a building to escape the rain, he finishes dinner, a ¥250 bento box of brown fish and rice. Asked whether he felt any effect when the Japanese economy recovered, he sneers. "The economy? It has nothing to do with my life."

Economist.com FINANCE & ECONOMICS

Buttonwood

The big bear

Oct 16th 2008
From The Economist print edition

History has to be rewritten after the market's recent falls

Illustration by S. Kambayashi

AT THE end of 1964 the Dow Jones Industrial Average traded at 874.1. Seventeen years later, despite rapid inflation, the average had inched forward only to 875. It was the kind of grinding bear market that drove investors to despair. Near its end, *Business Week* famously proclaimed "The Death of Equities".

It is beginning to look as if we are in the middle of another of those great phases, what commentators call a secular, as opposed to a cyclical, bear market. Broadly speaking, the 20th century can be divided into six phases; bear markets from 1901-21, 1929-49 and 1965-82 and bull runs from 1921-29, 1949-65 and 1982-2000.

Those unlucky enough to live through the bear markets saw their savings turn to dust. Equities were shunned in favour of alternatives such as government bonds (in the first half of the century) and property and commodities (in the inflationary second half). In the bull markets, investors made their fortunes, generally driving shares up to excessive valuations.

When the dotcom bubble burst in 2000, share valuations were at ridiculously high levels. In his book, "Irrational Exuberance", Robert Shiller calculated the cyclically adjusted price/earnings ratio over history. This measure, which takes an average of profits over the previous ten years and adjusts for inflation, is superior to the traditional p/e ratio because profits are highly volatile. In January 2000 the cyclically adjusted p/e on the S&P 500 was 44.3; the previous peak, just before the crash of 1929, was 32.6.

That suggested markets had a long way to fall. And share prices did indeed suffer a long period of decline. In Britain, for example, the FTSE 100 index more than halved between December 1999 and March 2003. At that point, however, the effect of lower interest rates, booming corporate profits and more attractive valuations kicked in. Equities began a four-year bull run that saw the MSCI world index more than double between March 2003 and June of last year.

During that time, it would have seemed ridiculous to ask whether investors were in the middle of a long bear market. But with global equities falling by 41% this year (including the spectacular gyrations of this week), the question is now much more pertinent. The Dow was trading below 9,000 on October 15th, a level it first passed in 1997. In other words, investors who bought stocks more than a decade ago have no capital gains to show for it, only dividends (and yields have been low throughout).

Why does this matter? The existence of a bear market does not preclude the possibility of fantastic returns over shorter periods. Indeed, one striking point about the Dow's 936-point gain on October 13th was that it climbed more in that one day than it did in the first 85 years of its existence (it was founded in 1896). Two of the very best years in American stockmarket history were 1933 and 1935, right in the middle of the Depression.

But bear markets behave rather like Lucy in the Peanuts cartoon strip. Just when Charlie Brown is persuaded to attempt to kick the football, she snatches it away. Just when investors are persuaded the bottom of a bear market has been reached, share prices slump once more. The Dow closed above 1,000 in 1972, only to fall to 616 by the end of 1974. A rally in 1975 took the average to 852, but it then gained only a net 23 points over the next six years.

Equity markets have again reached a stage where valuations look attractive in historic terms. In America, continental Europe and Britain the dividend yield is higher than short-term interest rates, a rare occurrence in the past half-century. A net 43% of fund managers interviewed by Merrill Lynch for a survey

published on October 15th thought that equities were undervalued. That was the highest level in a decade.

However, those managers were not snapping up bargains. A net 49% of them had a higher-than-normal weighting in cash, a record figure. That kind of paralysis is typical of a prolonged bear market.

Even if managers feel that a complete economic catastrophe has been avoided by the bank bail-outs, they are worried about the prospects for recession, and the potential effect on company profits. (Pepsi, a core consumer-goods group, gave a disappointing outlook on October 14th.) They might be proved right in five years' time by buying now, but they fear being proved wrong (and losing their jobs) before Christmas.

Snapping investors out of their bear-market mentality takes a lot of work. The shortest of the 20th-century phases was 17 years. With luck, time will move faster in the 21st century.

Sources of capital

Once bitten, twice shy

Oct 16th 2008 | DUBAI
From The Economist print edition

Will private equity and sovereign wealth funds invest in banks?

VIEWED against Dubai's ever-expanding horizon of cranes and skyscrapers, anything seems possible: even that Western banks might find capital from sources other than their governments. Yet at this week's buoyantly named "Super Return" conference, the mood among private-equity and sovereign-wealth types was unusually demure. Stephen Schwarzman, the boss of Blackstone, a buy-out firm, spoke for many when he warned of trying to "catch a falling knife and severing the tendons in your right hand".

Most governments hope that having guaranteed their banks' survival they will encourage outside investors to come back in. After all, private-equity firms are sitting on about $450 billion of "dry powder"—funds raised but not yet spent. And sovereign-wealth funds have assets of $2 trillion to 3 trillion, much of which is sitting idly in American Treasury bonds. Meanwhile, the IMF thinks American and European banks need $675 billion of new capital.

But will the blanket invitations to invest be accepted? Private equity needs to save part of its cash for recapitalising the mega-buy-outs of the boom era: much of the equity is now "toast", an industry veteran admits. But some firms do see bargains. David Rubenstein, a co-founder of Carlyle, a big buy-out firm, thinks the financial sector could present the "greatest opportunity" he has seen in 20 years.

The trouble is that buying into big banks alongside governments is not top of anyone's to-do list. Some specialist investors, such as JC Flowers and TPG, have already been badly burned. And clients who can invest directly in big quoted banks may balk at buy-out firms charging them high fees to purchase minority stakes on their behalf. Instead, many firms may limit themselves to distressed assets and buying (with government help) midsized American banks that they can run.

Sovereign-wealth funds, meanwhile, have been conspicuously absent. So far only Qatar's investment authority has been prepared to play the sugar daddy, with investments in Credit Suisse and also, reportedly, Barclays. The funds' reluctance partly reflects a liquidity scare in the Gulf, which has led several governments to support their own banking systems. Dubai's pessimists, a tiny but apocalyptic tribe, worry that some of Abu Dhabi's oil wealth may have to be spent helping its brash neighbour refinance its debts.

But the biggest impediment for many sovereign-wealth funds is the trauma they have suffered since investing in Western banks early this year. Typically since then the banks' share prices have at least halved, losing tens of billions of dollars for their sovereign investors and earning them the unhappy reputation of being "dumb money". No longer will they be smooth-talked into investing at very short notice in distressed institutions. Although Western government backing reduces the financial risk of such stakes, it also raises their political profile, which is unappealing to the potential investors.

Is attracting such capital a lost cause? Some will be tempted in. After all, the terms on offer were enough to attract Warren Buffett, an investing legend, to buy a stake in Goldman Sachs. But, broadly speaking, the recapitalisation of big Western banks is likely to be a two-stage process, with governments doing the heavy lifting first, before others are prepared to pile in. That could take years. Miracles do not happen overnight, even in Dubai.

Cross-border banking

Divided we stand

Oct 16th 2008
From The Economist print edition

The ugly side of international banking

IT IS an odd sort of togetherness. European leaders gathered in Paris on October 12th and proclaimed a set of common principles for handling the financial crisis that underscored the impotence of supranational bodies. If the worst really is over, it is because national governments in Europe and beyond have reached deep into their own pockets, extending guarantees and injecting capital into domestic banks.

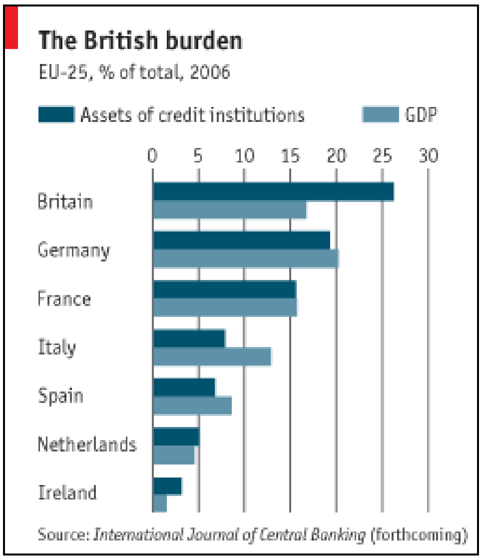
That reality has brutally exposed the weaknesses in cross-border banking. One concern is about the safety of retail deposits held at branches of foreign banks. Banks that operate abroad under the European "passport" scheme, whereby deposit-guarantee schemes in the bank's home country are the first port of call for foreign depositors, may well seem less attractive to savers in light of recent events. The collapse of the banking system in Iceland—a country that was recently listed as a spoof auction item on eBay—led the British government to make novel use of anti-terror laws to freeze Icelandic assets. It and the Dutch government have ended up lending money to Iceland so that their citizens can retrieve money from Landsbanki, one of the country's nationalised banks.

Another concern is about burden-sharing among countries in the event of a really big cross-border failure. The dismemberment of Fortis, a Belgo-Dutch bank, went relatively smoothly but as Simon Gleeson of Clifford Chance, a law firm, points out: "If you wanted to choose a group of countries to co-operate, the Benelux ones would be the ones you'd pick." Other institutions, such as the big Swiss banks, would pose bigger problems.

A third question is over liquidity. Many cross-border banks want to manage their liquidity centrally. That sounds fine unless an institution becomes insolvent and local offices suddenly need to stand on their own two feet. The European arm of Lehman Brothers did not even have its own bank account, but banked with its parent company. PricewaterhouseCoopers, the bank's administrator in London, has had to open an account at the Bank of England in order to avoid using banks with a claim on Lehman's estate.

This awkward mix of national bail-outs and cross-border contagion is not easily solved. A bank comprised of armour-plated local subsidiaries would satisfy regulators but threaten both economies of scale and the idea of the single market. Plans to beef up colleges of international supervisors, let alone to create a pan-European regulator, raise political questions.

Spreading the costs of recapitalising cross-border banks is also horribly tricky. In a forthcoming paper for the *International Journal of Central Banking*, Charles Goodhart and Dirk Schoenmaker, two academics, examine how European countries might agree to share this burden. Waiting to sort out the details of a rescue when crisis has struck makes it likely that some countries will duck their responsibilities. But agreeing on a formula for burden-sharing ahead of time would be particularly awkward for Britain, because its outsize share of EU banking assets could leave it on the hook for the cost of rescuing all sorts of banks (see chart). Europe may now be acting in concert, but it has a long way to go before it acts as one.



Trust

The faith that moves Mammon

Oct 16th 2008
From The Economist print edition

Only rarely does the glue that binds the financial system come unstuck

THE near-collapse of the banking system has shown just how deep some central parts of economic life are buried. Who, for instance, bothered much about the static interbank market before it seized up in August 2007? The supply of credit is bound up with something even more subterranean: trust. The very word comes from *credere,* to trust in Latin. When institutions, such as banks, that are supposed to embody trust are shown to be brittle, it leads to concerns about the fragility of the entire economy.

Much in modern economies is taken on trust. Even the most basic goods depend on complex links between suppliers strewn across the globe. The glue that binds the whole system together is trust—trust that suppliers will deliver the right goods on time; trust that the payments will duly pass down the supply chain. That raises a question: what makes people who might not even lend to their neighbours happy to lend their life savings to unknown borrowers whom they will never meet? Put it like that, and the surprise is not that there are sometimes periodic panics, but that there are so few of them.

In his 2004 book “The Company of Strangers” Paul Seabright, a professor at the Toulouse School of Economics, explored the roots of such seemingly reckless trust. He identified two helpful human traits. One is the capacity to weigh up the costs and benefits of trusting others. Allied to this is an instinct to return favours in kind, and to seek revenge when trust is betrayed. When workers are treated generously, they work hard; when customers are swindled, they raise a fuss. Reciprocal ties become strongest between people who meet and trade frequently. But reciprocity thrives elsewhere too, because it is embedded in habits of thinking and rules of behaviour. Tourists often leave tips in restaurants to conform to a social norm, though they may never eat there again.

These informal mechanisms are buttressed by state institutions such as regulators, bankruptcy procedures and the courts. These are used to settle only a small minority of disputes. The state is acting as a backstop for informal monitoring: in stable societies, transactions between strangers are mostly self-policing. A reputation for honest dealing is valuable for firms and employees alike. Suppliers gamble the rewards from future commerce for a short-term gain when they bilk their customers.

The comfort of strangers

When it works well, the banking system underpins trust and allows strangers to deal with each other safely. Banks enable savers to reduce risks by pooling their resources. Deposits offer safer returns than those from making a loan to any one borrower—even a trustworthy one who is known to the lender. Trust in banks depends on an illusion that funds are readily accessible, when most are tied up in long-term loans. It is an illusion that depositors play along with because they know that, absent a panic, not many of them will ever need to withdraw cash at the same time.

Yet banks are complex and opaque firms, which makes it hard for depositors to police their activities. Even regulators and informed investors struggle. A rumour, even a false one, is enough to trigger a run. Trust in institutions is so ingrained an instinct that, before the crisis, there was little concern about the safety of banks. Now, however, there is a noticeable surge in cash in circulation (because of banknote withdrawals) and a greater awareness of the limits of deposit-insurance schemes.

In these responses there are still signs of a durable trust in institutions, albeit ones backed by governments. When panicky investors sell stocks or liquidate their bank deposits, they renounce claims on real assets—factories, office buildings, homes—for pieces of paper with no intrinsic worth. Although the banking illusion has been unsteady, the illusion behind fiat money seems to have a tenacious hold.

Since banks are pillars of trust, the various bail-out schemes will have an impact beyond the securing of credit lines. Small businesses rely on informal credit to survive. If one firm fears that another cannot get

an overdraft because its bank is in trouble, it may demand that bills are paid sooner or even settled in advance. That loss of trust could sink many small but otherwise sound firms. Indeed Mr Seabright thinks that business cycles may be driven as much by the waxing and waning of trust in related firms as by "confidence"—firms' hopes and fears about future demand for their products.

Although trust in banks can be salvaged by state backstops, faith in the financial system may be harder to repair. For many, the crisis is the result of a shift from traditional "relationship banking", where borrowers are well known to lenders, to a new system of arms-length finance, where investors buy bundles of anonymous loans packaged in a security. A study published in the IMF's latest *World Economic Outlook* found that downturns are bigger in countries with arms-length finance, which dries up quickly in bad times. But the new finance merely mirrors (and even lags behind) a more general trend in modern economies towards arms-length commercial ties. The solution may not be a retreat to old-style banking, but better mechanisms to foster trust in the new finance.

For his part, Mr Seabright concludes that the main reason people place their trust in others is because it is less risky than the alternative. He senses a "nostalgia for self-sufficiency" induced by anxieties about globalisation. But this, he says, overlooks that "self-sufficiency is fantastically risky". Isolated people are often more vulnerable because they lack access to basic medical care and—when their harvests fail—to food. Integration with others massively reduces risk. Trust in strangers may be at odds with some of our instincts, but it is a price worth paying for a richer life.

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Economics focus

Bold strokes

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From The Economist print edition

A strong economic stylist wins the Nobel prize

Illustration by Jac Depczyk

WHEN Paul Krugman won the Nobel prize in economics on October 13th, the news was greeted with nostalgia as well as congratulation by some of his fellow economists. Since 1999 Mr Krugman has written a twice-weekly column for the *New York Times*, in which he has devoted himself to attacking the Bush administration and all of its works. The nostalgists feel these jeremiads have distracted him from the cutting-edge research that secured his reputation. The polemicist, they feel, has buried the theorist.

And yet the old Krugman is still recognisable in the new. Indeed, the arts of the columnist are not so far removed from Mr Krugman's style as an economist. In his most celebrated academic papers, Mr Krugman paints with bold strokes, striving to render his insights as starkly as possible. Like a good columnist, he cuts to the quick of a problem, stripping it of clutter and encumbering nuance. The result is a revealing caricature: what economists call "models".

Mr Krugman won the prize for his models of international trade and economic geography. Both belong to the same grand project he confidently launched just a year after earning his doctorate: "Before my 25th birthday," he has written, "I basically knew what I was going to do with my professional life." In 1978 he realised that a model of "monopolistic competition", published a year earlier by Avinash Dixit and Joseph Stiglitz, could help him introduce economies of scale into trade theory and beyond.

Economies of scale had long posed awkward problems for theorists. If bigger firms face lower costs, then in principle one firm should supply the entire market, thereby enjoying the lowest costs of all. But in the Dixit-Stiglitz model, this monopolising logic is offset by a countervailing force: consumers' taste for variety. People prefer to spread their custom over different versions of the same good. The market is therefore carved up among competing firms, each offering a product bearing its own distinctive stamp. The model is highly stylised. Nonetheless it gave Mr Krugman, as he put it, "a tool to open cleanly what had previously been regarded as a can of worms".

Mr Krugman used this tool to save economics from an abiding empirical embarrassment. According to one of the discipline's founding doctrines, countries gain from specialisation and exchange, concentrating on what they do best and importing the rest. The theory explains why the Portuguese might sell wine in exchange for English cloth. But it cannot explain why similar countries, blessed with similar ratios of capital, labour and land, should so vigorously trade similar goods back and forth. This is not a small blind spot. According to the World Trade Organisation, 52% of Germany's exports to France are things France also produces and exports to Germany. But the Dixit-Stiglitz model, with its subtly differentiated firms

competing for variety-loving consumers, lent itself to explaining why Germans might import Renaults, even as the French imported Volkswagens.

Mr Krugman's model showed that when trade barriers fall, firms gain access to bigger markets, allowing them to expand production and reap economies of scale. But openness also exposes them to competition from rival foreign firms, paring their margins. Some firms may go out of business. But between the domestic survivors and the foreign entrants, consumers still have more goods to choose from. Thus the gains from trade arise not from specialisation, but from scale economies, fiercer competition and the cornucopia of choice that globalisation provides.

Scale economies also allowed Mr Krugman to give economics for the first time a sense of space. In a 1991 article, he notes that night-time satellite photos of Europe reveal the distinctive contours of economic activity: bright lights cluster around metropolitan centres, shining particularly brightly around the triangle of Brussels, Amsterdam and Dortmund.

Before Mr Krugman, economists found these images difficult to square with the rest of their body of theory. They were accustomed to assuming that firms face constant returns to scale. But if that were true, then every peasant could build a small smelter or assembly line in his backyard. There would be no need for an economy to divide into a farm belt and an industrial belt.

Geography lessons

In Mr Krugman's model, by contrast, big factories benefit from lower costs of production. Manufacturing firms might therefore cluster near to a large market, leaving behind a sparsely populated hinterland, in order to make the most of scale economies and minimise the cost of transporting goods to their customers.

Earlier theorists had instead assumed that firms herd together to benefit from some kind of "spillover". Perhaps firms pick up tricks of the trade and other know-how from their neighbours. However plausible, these explanations were nonetheless unsatisfying. Because economists could not measure spillovers or delimit their scope ("How far does a technological spillover spill?" Mr Krugman wondered), they could invoke them to explain just about anything.

Mr Krugman's models instead identified a less elusive benefit of proximity. He pointed out that a firm's decision to locate in a district is a gift to other firms in the area, because in attracting new workers it also brings new customers. Unlike a technological spillover, this gift would in principle leave a paper trail, showing up in local firms' sales figures.

In neither contribution did Mr Krugman claim great originality for his ideas or great realism. His achievement was to formalise insights that many people had previously had informally. Ideas that had fluttered in and out of people's grasp for decades, he pinned down like a butterfly on display. Sometimes a good economist, like a good columnist, succeeds not by making a point before everyone else, but by making it better than anyone else.

Drug addiction

Treatment on a plate

Oct 16th 2008
From The Economist print edition

A dietary approach to treating addiction seems worth investigating

Alamy

PEOPLE are programmed for addiction. Their brains are designed so that actions vital for propagating their genes—such as eating and having sex—are highly rewarding. Those reward pathways can, however, be subverted by external chemicals (in other words, drugs) and by certain sorts of behaviour such as gambling.

In recent years, neuroscientists have begun to understand how these reward pathways work and, in particular, the role played by message-carrying molecules called neurotransmitters. These molecules, notably serotonin, dopamine and gamma-aminobutyric acid (GABA), hop between nerve cells, carrying signals as they go. Some drugs mimic their actions. Others enhance them. Either way, the body tends, as a result, to give up making them. At that point the person needs the drug as a substitute for the missing transmitter. In other words, he is an addict.

Unfortunately, this improved understanding of the biochemistry of addiction has yet to be translated into improvements in treatment. The latest figures from Britain's National Treatment Agency suggest that only 11% of those who start treatment complete it and are drug-free after 12 weeks. A new approach that acknowledges the underlying biochemistry might improve this situation. And on October 11th and 12th delegates to a conference in London, organised by Food for the Brain, an educational foundation, heard accounts of such an approach. Its tools are not drugs but dietary changes. The theory is that providing food rich in the precursors of lost neurotransmitters will boost the levels of those chemicals, and thus reduce craving. At the moment, only preliminary trials have been carried out. But they look promising and if larger trials confirm them, a useful, new front in the war on addiction might open up.

Mind what you eat

Anxiety and sleeplessness are common withdrawal symptoms. They happen because many addictive drugs reduce the supply of a chemical called glutamine, a precursor to GABA. One of GABA's roles is to promote relaxation. (The molecular receptors for GABA are the target of tranquillisers such as Valium.) But glutamine levels can be restored, and production of GABA boosted, by the consumption of an amino acid called N-acetylcysteine (NAC) that is found in nuts and seeds.

This is not just theory. A controlled study published last year in the *American Journal of Psychiatry* by Steven LaRowe, of the Medical University of South Carolina, and his colleagues, found that giving NAC to

cocaine addicts reduced their desire to use the drug sufficiently for it to be recommended as a treatment. A different study found that NAC reduced the desire to gamble in more than 80% of those addicted to this pastime, compared with 28% of those who were given a placebo.

Serotonin is another neurotransmitter that is usually deficient in an addicted brain. This probably accounts for the depressive side of withdrawal symptoms (serotonin receptors in the brain are the target of antidepressant drugs such as Prozac). Serotonin is made from an amino acid called tryptophan, which is found in foods such as meat, brown rice, nuts, fish and milk. Philip Cowen, a psychiatrist at Oxford University, has found that reducing the amount of tryptophan in someone’s diet increases depressive symptoms and also that increasing it can induce a more optimistic outlook.

Another molecule that shows promise in treating addiction is DHA, a fatty acid belonging to the nutritionally fashionable class called omega-3. In this case it is believed to act not by affecting neurotransmitter levels but by changing the physical characteristics of nerve cells’ outer membranes, and thus the way they conduct nerve impulses.

A lack of DHA has been associated with all sorts of psychological problems—learning difficulties, excessive hostility and even suicide. It has also been associated with the relapse into addiction.

Here, though, the waters are muddy. Correlation is not causation, and no decent trials have yet been done to show whether DHA supplements do in fact reduce addiction. Indeed, the whole area is, as it were, under-trialled. As David Smith, another Oxford-based researcher and the chairman of the conference, pointed out, drug companies are not interested in carrying out such trials because the results, even if favourable, are unlikely to be patentable.

Governments do not seem interested at the moment, either; the welfare of addicts, rhetoric aside, is rarely a priority. Similar studies of the effect of diet on the behaviour of prisoners are, though, provoking interest. John Stein, yet another Oxford man, is currently conducting such a study in three British prisons. If a change of diet really can help addicts, it would be a shame not to find out. It might even save the public purse some money.

Electronics

Looks good on paper

Oct 16th 2008
From The Economist print edition

A new use for a common material

ONCE in a while, someone takes a familiar material like glass and finds a new use for it. Glass had been around for ages but, in the 1950s, Basil Hirschowitz of the University of Michigan thought of using a fibre made of the stuff to transmit light. Fibre optics have since revolutionised both surgery (Dr Hirschowitz's original intention) and telecommunications (an unexpected bonus). Elvira Fortunato, Rodrigo Martins and their colleagues at the New University of Lisbon in Portugal believe they have found similarly a novel use for paper. Writing in *IEEE Electron Device Letters*, they describe how to use it to make a transistor.

Transistors are the workhorses of electronics. They are switches that employ one electric current to control the passage of another. Linked together on the surfaces of silicon chips, they form the "logic gates" that do the calculations in computers, mobile phones, television sets and the other electronic gadgets which dominate the modern world. The bold proposal that Dr Fortunato and Dr Martins are making is to replace the silicon with cellulose, the main ingredient of paper.

The silicon in a transistor has two separate roles. One, when it is doped with small amounts of other elements, is as a semiconductor. This is a material that permits the limited movement either of electrons (which are negatively charged) or of positively charged "holes" in the crystal lattice where an electron ought to be. Silicon's other role, when it is pure, is as a dielectric—a material that can be penetrated by an electric field, but not an electric current. It is silicon's role as a dielectric that Dr Fortunato and Dr Martins propose to replace.

The two researchers built their transistors by coating both sides of a sheet of paper with semiconductors made of oxides of zinc, gallium and indium, rather than silicon. They then deposited aluminium onto the coated paper to connect the resulting components together. One side of the paper carried the control currents while the other carried the output currents. The paper thus acted as the dielectric between the components of each transistor, as well as being the substrate for the circuit, in the same way that the base of a silicon chip acts both as substrate and as dielectric.

This approach lets the transistors be both flexible and cheap to produce. They can be made at room temperature, unlike a silicon chip, and paper is a lot less pricey than electronics-grade silicon. They also seem reliable. Dr Fortunato and Dr Martins tested their prototypes for two months without detecting any fall in performance.

Paper transistors, and circuits based on them, are not, it must be said, going to replace silicon chips as the microprocessors in computers any time soon—if only because they are nowhere near as miniaturised. But the two researchers have already used them to make a simple, disposable memory circuit, which they will describe in a forthcoming issue of *Applied Physics Letters*. Such paper-based "chips" would be much cheaper than the cheapest chips available today, and could be used in radiofrequency identification (RFID) tags on such things as packets of food on supermarket shelves—the cost of RFID chips is one of the factors preventing their widespread adoption. Baggage tags, banknotes with electronics embedded for security and even postage stamps that can be read by smart franking machines are other possible uses. Electronics may even come to rely on paper, rather than eliminating it.

Domestication

Not so dumb animals

Oct 16th 2008
From The Economist print edition

Wolves are, after all, cleverer than dogs

DOMESTICATION is not normally reckoned good for a species's intelligence. All that grey matter is expensive to grow, so if you have an owner to do your thinking for you, then you do not need so much of it. Natural selection (not to mention deliberate selection by people) might therefore be expected to dumb domestic animals down.

Dogs, however, look like an exception to this rule. Some, such as herding sheepdogs, have been bred for tasks that seem to involve a lot of intelligence. More intriguingly, an experiment carried out in 2004 by Brian Hare, then at Harvard and now of Duke University in North Carolina, suggested that natural selection in the context of domestication had boosted dogs' intelligence, too, by allowing them to understand human behaviour in a way that their ancestors, wolves, cannot. The latest study of the matter, however, suggests that is not the case after all, and that wolves, not dogs, are the clever ones.

Dr Hare's experiments involved showing his animals two upside-down cups, one of which covered food. A human would then gesture in some way at the cup covering the food. In theory, if the animal being tested was properly interpreting the gestures, it should have been lured to the object that the experimenter was indicating. And that is what Dr Hare found. Dogs selected the cup hiding the food far more than half the time, whereas the wolves he used for comparison got it right no more frequently than chance.

That led him to conclude that domestic dogs have evolved an ability to understand what their masters are up to by living among people for so long. Monique Udell of the University of Florida, however, begs to differ. She observed that Dr Hare's wolves, though captive, had not been raised among humans, and wondered whether learning rather than evolution explained his observations. Her team therefore worked with a mixture of pet dogs, dogs from animal shelters that had had minimal interaction with people, and wolves raised by humans. They exposed their animals to an experiment similar to Dr Hare's and came up with strikingly different results.

As they report in *Animal Behaviour*, the wolves outperformed both shelter dogs and pets. Indeed, six of the eight wolves followed human gestures perfectly in more than eight out of ten trials. Only three of eight pets were as successful as that and, as with Dr Hare's wolves, none of the shelter dogs performed better than chance. Far from being dumb, then, wolves are smarter than dogs. You just have to bring 'em up proper.

DNA sequencing

The hole story

Oct 16th 2008 | OXFORD
From The Economist print edition

Nanopores may lead the way to a new generation of sequencing

THE desk in Gordon Sanghera's office at Oxford Nanopore proudly displays a piece of knobbly plastic. It has a hole running through it and looks rather like a cruller doughnut, though with grey icing. In fact, it is a model of a protein molecule called alpha-hemolysin. Dr Sanghera, the firm's boss, believes this molecule will revolutionise the sequencing of DNA.

In nature, alpha-hemolysin is used by *Staphylococcus aureus*, a disease-causing bacterium, to punch holes in cells' outer membranes. The cell contents, particularly its ions (electrically charged atoms) then leak through the hole and it dies. Pushing a DNA molecule through the hole changes the speed at which ions pass. That will, in turn, be registered as a change in electrical current. The exact change varies with the bit of the DNA molecule that is passing through. So, in principle, the protein can record the order of the bases (the chemical "letters" that carry the genetic code) which make up the molecule.

If that idea can be put into practice it will, indeed, be a revolution. At the moment, sequencing DNA is slow and expensive. The molecule must be replicated many times (a step called amplification) and also labelled with fluorescent tags. These processes introduce errors and mean that a gene has to be sequenced several times to ensure a reliable result. Moreover, the cost of buying and operating the sequencing equipment is high. The result is that sequencing an entire genome costs hundreds of thousands of dollars.

In 2004 America's National Institutes of Health (NIH) challenged researchers to work out a way of sequencing a genome for $1,000. Many of the responses involve running strands of DNA through tiny pores of one sort or another and Jeff Schloss, a programme director at the National Human Genome Research Institute (which is part of the NIH), reckons this is a particularly fruitful approach.

These "nanopore" techniques, originally proposed by Hagan Bayley, a professor of chemistry at Oxford, in 1992, are simple, at least in principle. They do not need fluorescent labels and will probably not require amplification, either. They can "read" DNA directly and rapidly, and are cheap enough to replicate in vast numbers.

In the case of Oxford Nanopore's technology, the DNA molecule is fed through the hole one base at a time by a second protein, an enzyme called an exonuclease. This can clearly distinguish the four DNA letters, A, C, G and T. It may also be able to detect whether a letter is methylated, though this has not yet been independently verified.

Methylation, the addition to a base of a group of three hydrogens and a carbon atom, is one way in which genes are regulated. It seems to be important in some sorts of cancer, and there is also evidence that regulation by methylation can be passed from parent to offspring, meaning that characteristics acquired by one generation may be inherited by the next. The importance of such "epigenetic" inheritance is controversial; some researchers reckon it trivial while others think its role is underestimated. The ability to track methylation is thus scientifically important.

Though the firm has proved the principle, a single pore would take about 70 days to sequence an entire human genome (which has roughly the same number of letters as 1,000 Russian novels). So, in another laboratory on the other side of the science park, its researchers are working on ways of integrating the thousands of nanopores needed to read a genome in a day. Their working model is a shoebox-sized package of electronics and liquid-filled tubes, with a silicon chip at its core. The chip has 128 tiny wells, and inside each of these wells are the nanopores.

Dr Sanghera is unwilling to say how soon he will have a product, but other firms are breathing down his neck. Pacific Biosciences of Menlo Park, California, for example, eschews nanopores in favour of a technique that uses fluorescence to watch DNA molecules being built up, base by base, though it reckons

it will not have a product until 2010. Which all bodes well for the NIH's challenge. The next, far bigger question, is—when this era of cheap, personalised genomics finally does arrive, what will be done with all the data?

Correction: mobile phones

Oct 16th 2008
From The Economist print edition

In “Mobile madness”, published on September 27th, we said that Ronald Herberman, the director of the University of Pittsburgh Cancer Institute, issued a memo in July based on “early unpublished data”, in which he urged his staff to limit their use of mobile phones. The memo was, in fact, based on a review of the results from many published sources. Sorry for the error.

Warren Buffett

A sage that knows his onions

Oct 16th 2008
From The Economist print edition

Bloomberg

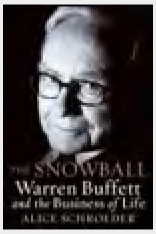
The authorised biography of the world's greatest investor

IN 1940, a stockbroker from the Midwest took his ten-year-old son on a trip to New York City. They dropped in at the office of Sidney Weinberg, who was trying to restore the reputation of Goldman Sachs, the investment bank that had been disgraced during the great crash of 1929. Weinberg took the time to chat to the precocious youngster, even asking the name of his favourite stock.

That may have been the most productive half-hour of Weinberg's life. Sixty-eight years later, Goldman Sachs turned to that lad, now one of the richest men in the world, for a capital injection of $5 billion. The infusion of Warren Buffett's money, and the backing of his reputation, means that Goldman has so far escaped the fate of Bear Stearns and Lehman Brothers during the recent credit crunch.

The broad outline of Mr Buffett's story is widely known. Like many shy small boys, he liked collecting, categorising and measuring things. Money was just another way of keeping score and he steadily built up his boyhood savings through paper rounds and small businesses like recycling pinball machines. These savings were the basis of his fortune—the snowball of Alice Schroeder's title growing steadily bigger as Mr Buffett pushed it through life.

The Snowball: Warren Buffett and the Business of Life
By Alice Schroeder



Bantam; 976 pages; $35. Bloomsbury; £25

A period studying under Ben Graham, the doyen of investment analysis, allowed Mr Buffett to strike out on his own, managing other people's money. Those residents of his hometown of Omaha, Nebraska, who backed the scruffy young man in 1956 have become fabulously rich. From buying shares, it was but a small step to purchasing whole businesses and one of these, an unpromising textile mill called Berkshire Hathaway, became the basis for his current fortune.

As his wealth grew, so did the legend. He has a reputation for shrewdness. Mr Buffett buys when others are selling and he acquires stakes in businesses that he believes will last—franchises like Coca-Cola and the *Washington Post*. As a result, he tends not to sell, letting the snowball gather weight as it rolls downhill. Equally celebrated is his homespun wisdom. Annual reports are normally dull stuff, but Berkshire Hathaway's publishings are collectors' items, thanks to Mr Buffett's pithy prose (polished by Carol Loomis, a renowned *Fortune* journalist). The sage of Omaha, as he has come to be known, has

been on the right side of most financial issues, warning against the excesses of the dotcom boom in the late 1990s and describing derivatives as “financial weapons of mass destruction”.

A man renowned for stinginess in his early years has become a great philanthropist. Not only is Mr Buffett giving away the bulk of his fortune, but he is also handing it to the Gates Foundation, reasoning that the Microsoft founder and his wife would do a better job of disbursing it. As Ms Schroeder remarks, he “was giving away his money without leaving a trace of himself behind…no Buffett hospital wing, no college or university endowment or building with his name on it”. Indeed, Mr Buffett is remarkably liberal for such a wealthy man. He favours inheritance tax and gives money to such causes as birth control and anti-nuclear campaigning.

The fascination with Mr Buffett’s rise means that bookshelves are already groaning under the weight of books about his life and his investment approach. This latest effort is certainly the heaviest. Those hoping for detailed analyses of his investment record will be disappointed that the author focuses so much on the state of the Buffett marriage. This reviewer, for example, wanted answers to several questions that are not addressed. How much of Mr Buffett’s success can be put down to his shrewd use of insurance company funds, or a few stock picks in the 1970s? What is the make-up of his business empire today and how does it differ from the 1980s? Because his insurance companies write policies against catastrophes, how vulnerable is he to the kind of “black swan” effect described by Nassim Nicholas Taleb, such as an earthquake or hurricane that could wipe out his wealth? The reader is left none the wiser.

Mr Buffett deserves careful scrutiny rather than the mostly hagiographic portrayal he has generally received from the press. He has relied heavily for advice and support on his advisers and his family, yet the role of his grumpy business partner, Charlie Munger, the Walter Matthau to Mr Buffett’s Jack Lemmon, has been underplayed. His businesses have survived investigations by the Securities and Exchange Commission, including one crucial episode that appears only in an epilogue to this book. The author seems unable to decide whether Mr Buffett is a hands-off executive who lets his managers get on with it (and is thus not responsible when they step over the line) or a man so obsessed with detail that he monitors weekly sales figures from the group’s sweet shops.

All in all, though, over a 50-year career the Buffett balance sheet has a lot more entries in the credit than in the debit column. Those who wish to know more may read this book. But Mr Buffett’s collected essays and annual reports would be a better place to start.

The Snowball: Warren Buffett and the Business of Life.
By Alice Schroeder.
Bantam; 976 pages; $35.
Bloomsbury; £25

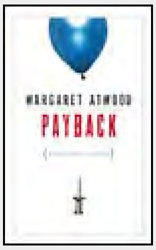
A cultural history of debt

Payback

Oct 16th 2008
From The Economist print edition

WITHOUT debt there would be no capitalism; mankind would be living in caves and eating whatever it killed. But Margaret Atwood's elegant and erudite canter round the literary, cultural and historical aspects of borrowing, lending, owing and repaying has less to do with economics than with human nature. Her new book is a collection of radio talks, conceived and delivered long before the current crisis, but its publication is remarkably timely.

Payback: Debt and the Shadow Side of Wealth
By Margaret Atwood



House of Anansi Press; 280 pages; $15.95. Bloomsbury; £9.99

Buy it at
Amazon.com
Amazon.co.uk

Debt is as old as human civilisation. The first recorded laws had to do with repayments and repossessions. The idea of debt depends on a common sense of fairness: if you borrow and don't pay back, justice is violated. That is not exclusive to humans; chimpanzees seem to have similar ideas. But debt is not morally neutral. Borrowing too much is a sign of depravity. So is being a merciless lender. Debt metaphors ("overwhelmed", "drowning", "crushing") are dramatic. In the end, money is time, and you may pay with your life—if not through death, then through drudgery.

The best bits of "Payback" are about debts that do not involve money. What do people owe to the planet? To other people? To God? The author is particularly taken with Charles Dickens's "A Christmas Carol", a story usually read only as a sentimental fable. Ms Atwood strips it down and rebuilds it with the brisk pen of an expert literary critic. The Archangel Gabriel bears the same relationship to God as Bob Cratchit does to Scrooge, she argues. It sounds odd, but makes perfect sense when you read it.

Ms Atwood weaves in all kinds of literary references from nursery rhymes to modern fiction, from Aeschylus to Darwin, via Mary Poppins and Charles Kingsley's "The Water Babies" (where the lovely Mrs Doasyouwouldbedoneby is the counterpart to the severe Mrs Be-donebyasyoudid). As one would expect from a novelist of Ms Atwood's calibre, the phrasing is polished and the metaphors striking: revenge taken in red ink can be even more satisfying and gruesome than that taken through red blood.

One criticism is her caricature of Christianity, which has shaped Western thinking about the debt of sin and the means of redemption for the past two millennia. Ms Atwood's apology for squashing Christian theological thinking into two chatty and disrespectful pages does not sound wholly sincere.

But the overall effect of the book is stimulating, if a trifle dizzying. Even Ms Atwood, scintillating wordsmith though she is, cannot quite patch holes in the logic. Her greenish, gently leftish convictions poke through rather too visibly sometimes. Ultimately, debt is a way that people bet on their own futures, placing a wager on their own ability, cleverness, diligence and luck. When those bets fail, the consequences for the loser can be sad. But the world is a better place, on the whole, if people have the right to make such wagers in the first place.

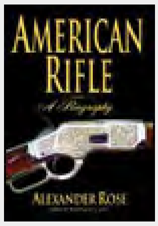
Payback: Debt and the Shadow Side of Wealth.
By Margaret Atwood.
House of Anansi Press; 280 pages; $15.95. Bloomsbury; £9.99

Sons of a gun

Oct 16th 2008
From The Economist print edition

THE belief that its riflemen are the world's best marksmen runs through America's military history. It dates back at least to the American War of Independence (1775-83) when sharpshooters born and bred on the frontier killed a disproportionate number of British officers. Their long shots were effective but their deliberate targeting was nonetheless deplored by the British army, whose soldiers armed with muskets advanced in formation in full sight of the enemy.

American Rifle: A Biography
By Alexander Rose



Delacorte Press; 512 pages; $30

Buy it at
Amazon.com

George Washington was in two minds about the tactic. He expected his riflemen to "skulk" in the Indian manner but ordered that if any other kind of soldier "shall attempt to skulk, hide himself or retreat from the enemy without orders of his commanding officer, he will instantly be shot down as an example of cowardice." By the mid-19th century American riflemen, whether hidden or not, were internationally famed as crack shots. As Alexander Rose, a military historian, shows in his rigorous account, this reputation had sound statistical support. An infantryman on the Unionist side in the American civil war (1861-65) was, on his reckoning, five times as good at hitting his foe as his Mexican, British or Continental European counterpart.

Yet this sharpshooting tradition has not always served America well. Mr Rose argues, counter-intuitively, that the pride the American military takes in marksmanship sometimes delays its acceptance of a more lethal new rifle which is (often wrongly) believed to be less accurate than existing ordnance. On the civilian side, the National Rifle Association, a mighty lobbyist, has the huntsman's bias for precision over power. Similarly conservative, the United States Marine Corps has an almost mystical relationship with its rifles. In its "Rifleman's Creed" a recruit swears before God to treat his rifle as his best friend, his brother and the saviour of his life.

This helps explain the Marines' disinclination early on in the second world war to adopt the M1 Garand, a semi-automatic which for the first time in many years put America ahead of Britain, France and Germany, its traditional competitors in rifle development. The Marines only changed their minds after their beloved but antiquated Springfield M1903, a rifleman's rifle, proved inadequate when they stormed beaches in the Pacific held by the Japanese.

Mr Rose includes detailed medical accounts of the damage done to pigs in test firings and to soldiers in battle. He is caustic about military euphemisms for horrific deaths. Even so, the overall tone of this "biography" of the rifle is nostalgic, heroic, almost celebratory. The very names of the rifles resonate with anybody brought up on westerns and war films: the Kentucky, forever associated with backwoodsmen like Davy Crockett and Daniel Boone; the Winchester that tamed the wild west; even the contemporary Special Operations Combat Assault Rifle (SCAR), although Mr Rose admits it lacks "the gorgeous lines" of the rival XM8. The best antidote to such romanticism is perhaps the rueful reflection of Robert E. Lee, a gallant Confederate general: "It is well that war is so terrible! We should grow too fond of it!"

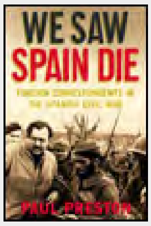
American Rifle: A Biography.
By Alexander Rose.
Delacorte Press; 512 pages; $30

The Spanish civil war

A call to arms

Oct 16th 2008
From The Economist print edition

We Saw Spain Die: Foreign Correspondents in the Spanish Civil War
By Paul Preston



Constable; 436 pages; £20

Buy it at
Amazon.co.uk

“IN SPAIN two vast world forces are testing each other out: if Franco conquers, Europe will be black or Europe will go to war as soon as Hitler and Mussolini are ready.” That was the correct prediction in 1936 of Louis Fischer, an American journalist so convinced of the dangers of Franco’s fascist rebellion that he joined the International Brigades to take up arms on behalf of the Republican government.

Fischer was hardly alone in his devotion to the Republican cause: in an excellent account of the foreign reporting of Spain’s three years of savage fratricide, Paul Preston cites an impressive list, from America’s egotistic Ernest Hemingway to Britain’s self-effacing Henry Buckley. By contrast, enthusiasts for Franco’s rebels were few (Mr Preston singles out William P. Carney of the *New York Times* for special, scornful mention). As Mr Preston explains, foreign correspondents were given relatively free rein by the Republicans’ press office, with easy access to the front lines. On the Francoist side they were often threatened with prison and execution.

So why did the reporting of so many pro-Republic correspondents not persuade outside powers, notably Britain, America and France, to lift their arms embargo on the hard-pressed Republicans? A prime reason was the fact that the Republicans were backed, more in materiel than men, by Stalin’s Russia: an antipathy to communism was, it seems, a good enough excuse to overlook the presence in Franco’s forces of German and Italian troops. Outside opinion was also offended by the anticlericalism of the Republican side, with its attacks on priests and vandalism of monasteries. Some of these attacks were horrible enough; others were exaggerated by Francoist sympathisers. Mr Preston notes that Carney invented many of his stories, which pro-Catholic editors at the *New York Times* printed despite the anguish of Herbert Matthews, its more objective correspondent on the Republican side.

Mr Preston’s own preference for the Republican cause is obvious, but it does not deter him from detailing the spying for their governments of several pro-Republic correspondents. He devotes a fascinating chapter to Russia’s Mikhail Koltsov, a *Pravda* correspondent for whom Republican Spain was an inspiring antidote to the terror of his homeland—and whose loyalty to Stalin was rewarded by torture and execution. Fischer, writing mainly for the *Nation*, was not a spy, but he was so well-connected in both Europe and America that his advice was welcomed by American and Soviet politicians alike.

One weakness of Mr Preston’s book is his concentration on the English-language press (Koltsov apart, non-Anglophone journalists are mentioned mainly in passing). Another is an overlong chapter on the dispute between Hemingway and John Dos Passos on the disappearance of Dos Passos’s friend, José Robles. But these are small criticisms. The author paints a marvellous portrait of the world of the war correspondent: the risk to life; the temptations to infidelity (Hemingway’s affair with Martha Gellhorn was hardly exceptional); and, in the days before satellite phones, the constant struggle to get the story out.

The story was tragic, not just as a prologue to the second world war but also because it condemned Spain to decades of dictatorship. Implicit in this book is the thought that, if the correspondents had been listened to, the outcome could have been different. As Mr Buckley later wrote, the outside world cared more for Spain’s art works, spirited to safety in Geneva, than for its thousands of refugees.

We Saw Spain Die: Foreign Correspondents in the Spanish Civil War.
By Paul Preston.
Constable; 436 pages; £20

The birth of blues

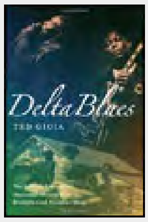
Deep roots

Oct 16th 2008
From The Economist print edition

Illustration by Daniel Pudles

"THE blues had a baby and they named the baby rock and roll." So sang Muddy Waters, one of the greatest bluesmen. While true, that is only part of the absorbing story Ted Gioia tells as he traces the blues, a seminal influence on all 20th-century popular music, back to its roots. The delta of his title is a vast tract of land between the Mississippi and Yazoo rivers, a source of agricultural riches, particularly cotton, and home to a poor black population whose very privation inspired an impassioned musical culture.

Delta Blues: The Life and Times of the Mississippi Masters Who Revolutionized American Music
By Ted Gioia



Norton; 448 pages; $27.95 and £16.99

Buy it at
Amazon.com
Amazon.co.uk

Mr Gioia's authoritative chronicle interweaves the steamy character of the delta with the hard lot of its population. Toiling in conditions not far removed from slavery, at the mercy of plantation and prison farm, the delta's sharecroppers expressed themselves through the blues, a vocal form derived from Africa, as well as from work songs and spirituals. Although the blues appeared in other places in the American South, the delta was astonishingly prolific in quality, abundance and sheer intensity. As the author puts it, afficionados reckoned there were blues, then deep blues, but delta blues had "the deepest roots of all".

Mr Gioia's book is made up of a chronological series of biographies of the region's musical heroes, who became famous for a style in which singing and guitar playing merged into a single mesmerising sound. Charley Patton, Bukka White and Son House all won local renown, made recordings and then faded away into delta life, in which passion and violence often went hand in hand. Robert Johnson, who was supposed to have sold his soul to the devil in return for his prodigious skills, was poisoned after an ill-advised dalliance with another man's woman.

Johnson's recordings brought the delta's spell to a wider audience, as did the migration of a new generation of musicians northward, particularly to Chicago. From the 1940s, the Windy City became a hub for giants such as Waters and Howlin' Wolf, who added a new dimension to the blues with supercharged amplification. The plangent attack of electric guitar and harmonica gave the delta style greater intensity. Hard-driving bands superseded soloists, but the redoubtable Mississippi-born John Lee Hooker could still galvanise a room all by himself with his stomping "Boogie Chillen".

With such emotional energy afoot, cocking a snook at well-scrubbed post-war pop, it wasn't long before the blues burst on to the mass market. Its carefree offspring, rock and roll, went on to become a huge commercial enterprise in which every singer affected a bluesy cry as a testament of personal emotion.

But Mr Gioia is in no doubt that delta blues retains its appeal. He describes the revival movement in which enthusiasts tracked down some of the region's first stars, who brought the old sound alive. Records still convey the power of their music and of the delta tradition; a fire, Mr Gioia says, that is just waiting to be rekindled.

Delta Blues: The Life and Times of the Mississippi Masters Who Revolutionized American Music.
By Ted Gioia.
Norton; 448 pages; $27.95 and £16.99

Milan Kundera

The unbearable weight of history

Oct 16th 2008
From The Economist print edition

A long-buried scandal may taint a giant's reputation

MILAN KUNDERA'S poignant novels epitomised the tragic division of central Europe from the rest of the continent. Works such as "The Unbearable Lightness of Being" told of lives clouded or ruined by totalitarianism.

The story of Miroslav Dvoracek, a Czech spy for the West, would fit well into a Kundera novel. Caught by the secret police in 1950 while on an undercover mission to Prague, he was tortured and then served 14 years in a labour camp. He was lucky not to be executed. He has spent nearly six decades believing that a childhood friend called Iva Militka betrayed him; he had unwisely contacted her during his clandestine trip. Similarly, she has always blamed herself for talking too freely about her visitor to student friends. Now a police record found by Adam Hradilek, a historian at the Institute for the Study of Totalitarian Regimes, in Prague, suggests that it was one of those friends, the young Mr Kundera, who was the informer.

Mr Kundera, a recluse for decades, insists that he had no involvement in the affair and is baffled by the document. Communist-era records are not wholly trustworthy. But a statement from the Czech archives says it is not a fake; the incident (if it happened) could help explain why Mr Kundera, then in trouble with the authorities, was allowed to stay at university even though he had been expelled from the Communist Party.

True or not, the story echoes themes of guilt, betrayal and self-interest found in Mr Kundera's own work, such as "unbearable lightness" (dodged but burdensome responsibility). In "The Owner of the Keys", a play published in 1962, the hero kills a witness who sees him sheltering a former lover from the Gestapo.

As Mr Kundera himself has written so eloquently, "the struggle of man against power is the struggle of memory against forgetting." Under totalitarianism, fairy tales good and bad often trumped truth. Some heroes of the Prague Spring in 1968 had been enthusiastic backers of the Stalinist regime's murderous purges after the communist putsch of 1948.

Mr Hradilek surmises that Mr Kundera probably acted out of self-interest, not malice or conviction. Millions faced such choices in those times. Some have owned up; many have not. Countless episodes like that linger over eastern Europe like an invisible toxic cloud.

Portraits from the Renaissance

Head and heart

Oct 16th 2008

A new exhibition shows how the portrait became personal

THE portrait, as it is known today, was born in the Renaissance. Portraits had existed before the 15th century, of course: just think of the Pharaohs with their colossal statues, the busts of the Roman emperors or the painted faces of donors in medieval altar pieces. But those figures seemed very remote. Renaissance artists, by contrast, sought to create not just a likeness of their subjects, but also something of their spirit.

Portraiture became very popular. Indeed, the principal question addressed by "Renaissance Faces", a new exhibition at London's National Gallery, is why, at this time, did so many patrons commission portraits of themselves, their lovers, friends and children? Answers emerge in seven rooms filled with paintings, medals, drawings and sculpture. The show also seeks to correct the misconception that Renaissance portraits were the exclusive invention and preoccupation of artists in the south of Europe, especially Italy. As its subtitle makes plain, this is a European exhibition: Van Eyck, after all, painted in Flanders; Titian was a Venetian. But pleasure has not been sacrificed to art history. Susan Foister, the show's lead curator, stresses above all that the gallery wants visitors to enjoy themselves.

On the simplest level, the exhibition is a treat for art lovers—with works by Holbein, Titian, Raphael and Dürer—and for people watchers. There are musicians and poets, kings and queens, brides and grooms. Even the dead are brought back to life by artists working from death masks. Some subjects seem arrogant, some sweet, others show off, some look as if they want to flee. A great portrait is not an exercise in photographic realism, but a work of skill and imagination. A painter might, for example, enlarge one eye and narrow the other or lengthen a neck to produce a particular effect. Giuseppe Arcimboldo even made portraits out of seasonal fruits, vegetables and flowers.

On entering the exhibition visitors are greeted by "The Beautiful Florentine", a painted wood statue recently found to be an image of Saint Constance, one of the martyred, virgin companions of Saint Ursula. This heavy-lidded, ethereal blonde, with her fashionable Tuscan hairstyle and intricately decorated red and gold gown, stands alone on a pedestal. No one knows what Saint Constance looked like, nor who she was or who modelled for this sculpture. But the artist's goal is clear: this is an idealised portrait made at a time when it was believed that inner perfection and goodness manifested itself as physical beauty.

National Gallery

Other rooms focus on attributes and allegory (anything, from a squirrel to a violet to scissors, gave information about the nature or interests of a sitter); courtship and friendship; family; love and beauty (which naughtily includes "The Ugly Duchess" attributed to Quentin Massys); drawing portraits and, lastly, portraits of rulers. The faces of royal children are shown in little studies which their parents could carry with them on their travels; so are lovers and newlyweds, or, in the case of Henry VIII, a distant prospective bride.

Throughout the show, works from the National Gallery's permanent collection hang alongside loans, often to surprising effect. In its traditional spot in the gallery, for example, Giovanni Bellini's "Doge Leonardo Loredan" appears as a head of state—stern, imperious and wise. But in this more intimate space it is easier also to see him as a human being.

In the final room Raphael's revered portrait of Pope Julius II has been hung alongside Titian's "Pope Paul III Bare-headed" (pictured above), which has been lent by the Museo di Capodimonte in Naples. Pope Julius, wearing crimson velvet and heavy rings, looks old and weary; living evidence that high office and its trappings cannot stop age from doing its worst. Pope Paul, too, is dressed in crimson velvet and also sits

looking old and bent. Yet, here, Paul shows a humanity that seems to transcend the depredations of old age, and this Titian outshines every other picture in the room.

Jörg Haider

Oct 16th 2008
From The Economist print edition

Jörg Haider, an Austrian populist, died on October 11th, aged 58

EPA

IF YOU wanted to see a Nazi in Jörg Haider, it wasn't difficult. The tanned, cold, Aryan good looks, the liking for black leather, the taste for extreme sports and fast cars, all hinted at it. So did the youthful membership of pan-Germanic mock- duelling clubs, the black-cross flags, the foggy Remembrance Day trysts with SS officers and the band of crop-haired followers who were liable to break out in a chorus of "Tomorrow Belongs to Me". His father had been an illegal Nazi long before the Anschluss, and his mother a local leader of the League of German Maidens; their de-Nazification after the war, with Robert made to dig graves and Dorothea banned from teaching, struck their son (though he did not remember it) as brutal injustice.

Then there were the remarks, few enough, but indicators of a certain current of thought. Hitler's employment policies had been "orderly", he said, unlike the modern Austrian government's; words that forced him to step down briefly in 1991 from the governorship of Carinthia. The SS veterans he mixed with were men of "character", "honour" and "conviction". The phrase *Überfremdung*, foreigner overrun, which crept into his immigration-talk, had not been heard since Nazi days. And though he once picked a Jew as his deputy at the top of the Freedom Party (FPÖ), he could not help wondering aloud how the head of the Jewish community, Ariel Muzicant, apparently named after a soap powder, could have such dirty hands.

The rest of Europe certainly took him at those words, and when the FPÖ notched up its best electoral result in 1999, 27% of the vote and a place in the governing coalition, EU sanctions were placed on Austria. Many Austrians were ashamed of Mr Haider; but others were aware that he articulated their country's confusion about the past, a mixture of defiance and repentance, victimhood and guilt, and the struggle to expel old ghosts. Mr Haider, too, talked of "drawing a line" under Nazism and declared that he wanted *keine braunen Schatten*, no brown shadows. The outside world found such mumblings unconvincing. Mr Haider retorted that this was not the world's business.

The Haider show at home (and it was always a show of sound, speed, lights and glamour) had a different feel. There he was the Carinthian boy-wonder, waltzing round his adopted deep-south base in a bone-buttoned loden jacket, wolfing *Strudel* and *Nudel* washed down with Jörg Bear beer and handing out 5,000 ski passes for the Gerlitzen to mark his 50th birthday. He lorded it like a local count on €10m-

worth of forested slopes in Bärental, bought for a song by an uncle in 1941 from a Jew fleeing for Italy. As Carinthia's governor for the past decade (in a border province that had been successively invaded by Mongols, Turks and Slavs), Mr Haider played the Austrian patriot, defying the law to ship criminal immigrants from eastern Europe across to Styria on the night bus, uprooting Slovene road signs and plastering towns with posters promising a clean sweep of filthy foreign beggars.

The eternal chancer

All this hard-right politicking gave the jitters to some. But Mr Haider, sly as a snake and sharp as a razor, was not so easily defined. When Austria's ruling parties opposed Turkish membership of the EU, he supported it. Austria's own accession he first endorsed, then passionately resisted (leading the "No" forces in the 1994 referendum), then accepted. When Saddam Hussein was a pariah, he went to Baghdad to shake his hand. His most admired politician was Archduke Johann, a modernising 19th-century governor of Styria, closely followed by Newt Gingrich and Tony Blair. His ideology shifted with whatever group he was talking to, conservative one moment and leftish the next, as various as the suits, jeans, Robin Hood outfits, puffer ski-jackets and medieval robes in which he clad himself. It was often said that the only "ism" he ever embraced was populism.

This made him, for all his toxicity, a tantalising oddity in Austrian politics. In a country corruptly dominated since the war by "black" (conservative) and "red" (socialist) parties, allocating by the entrenched *Proporz* system all seats and posts of any consequence, the blue-flagged FPÖ offered an eruption of difference. Many objected when Mr Haider, after his putsch in 1986, gave such a hard-right shove to a party briefly attempting to be liberal. But he thought of it as a vehicle for saying the unsayable, testing the new and generally raising Cain. Behaving this way was a *freiheitliche*, a truly liberal, thing to do.

When Mr Haider died, smashed in his black car on the road to Klagenfurt, he had just reassumed leadership of the Alliance for Austria's Future, the party he formed in 2005 after splitting from the FPÖ. (There had been many rows, flouncing-outs, reconciliations; this one was unmendable.) His new party had gained 11% of the vote in September's elections; he was on the up again in national politics, though never, it was clear, as far as a post in government.

His death itself was the last dramatic Haider show, speeding drunk along a road where he had narrowly escaped death before, crashing into a concrete pole, flipping over time after time. Once more, he played the chancer. Some supporters also thought he was escaping agents of Mossad.

Overview

Oct 16th 2008
From The Economist print edition

World stockmarkets veered between relief at the rescue of many countries' banks and alarm at the prospects for the world economy. The MSCI world index rose by 9.3% on Monday October 13th, only to fall by 7.1% two days later.

America's economy looked particularly weak. The value of retail sales fell by 1.2% in September, following a 0.4% fall in August. Car sales fell by 4.2% in September, leaving them 20.2% lower than a year earlier.

Oil prices continued to slide. The price of a barrel of West Texas Intermediate blend closed below $80 for the first time in a year.

Iceland's central bank slashed its benchmark interest rate from 15.5% to 12%. It said the collapse in the country's banking system would produce a "very sharp" recession.

Britain's unemployment rate, based on a survey of households, was 5.7% in the three months to August, up sharply from 5.2% in the previous quarter. Consumer-price inflation rose to a 16-year high of 5.2% in September, but is expected to fall back soon.

Norway's central bank cut its benchmark interest rate by 0.5 percentage points, to 5.25%, with effect from October 16th.

Industrial production in the **euro area** rose by 1.1% in August, following three consecutive months when it fell. Despite this sharp rise, output in August was 0.7% lower it had been a year earlier.

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WEEKLY INDICATORS

Output, prices and jobs

Oct 16th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product latest	qtr*	2008†	2009†	Industrial production latest	Consumer prices latest	year ago	2008†	Unemployment rate‡, %
United States	+2.1 Q2	+2.8	+1.6	+0.6	−1.5 Aug	+5.4 Aug	+2.0	+4.5	6.1 Sep
Japan	+0.7 Q2	−3.0	+0.7	+0.6	−6.9 Aug	+2.1 Aug	−0.2	+1.8	4.2 Aug
China	+10.1 Q2	na	+9.8	+8.5	+12.8 Aug	+4.9 Aug	+6.5	+6.4	9.5 2007
Britain	+1.5 Q2	nil	+1.1	+0.1	−2.3 Aug	+5.2 Sep§	+1.8	+3.8	5.7 Aug††
Canada	+0.7 Q2	+0.3	+0.8	+1.4	−2.1 Jul	+3.5 Aug	+1.7	+2.8	6.1 Sep
Euro area	+1.4 Q2	−0.7	+1.2	+0.6	−0.7 Aug	+3.6 Sep	+2.1	+3.5	7.5 Aug
Austria	+2.2 Q2	+1.5	+2.1	+1.0	−0.4 Jul	+3.7 Sep	+2.1	+3.0	3.3 Aug
Belgium	+1.9 Q2	+0.9	+1.5	+0.9	+2.5 Jul	+5.5 Sep	+1.5	+4.5	11.2 Aug‡‡
France	+1.1 Q2	−1.3	+1.1	+0.7	−2.6 Aug	+3.0 Sep	+1.5	+3.2	8.0 Aug
Germany	+1.7 Q2	−2.0	+1.6	+0.6	+1.7 Aug	+2.9 Sep	+2.7	+2.9	7.6 Sep
Greece	+3.5 Q2	+3.1	+2.4	+1.5	−1.8 Aug	+4.6 Sep	+2.9	+4.6	7.0 Jul
Italy	−0.1 Q2	−1.1	+0.1	+0.3	−5.3 Aug	+3.8 Sep	+1.7	+3.6	6.8 Q2
Netherlands	+3.0 Q2	+0.5	+2.1	+1.0	−1.3 Aug	+3.1 Sep	+1.3	+2.5	3.8 Sep††
Spain	+1.8 Q2	+0.4	+1.4	+0.3	−11.2 Aug	+4.5 Sep	+2.7	+4.5	11.3 Aug
Czech Republic	+4.6 Q2	+3.6	+4.5	+4.3	−2.6 Aug	+6.6 Sep	+2.8	+6.6	5.3 Sep
Denmark	+0.9 Q2	+1.6	+0.6	+0.8	−0.2 Aug	+4.2 Sep	+1.2	+3.3	1.6 Aug
Hungary	+2.0 Q2	+2.3	+2.0	+3.3	−5.9 Aug	+5.7 Sep	+6.4	+6.5	7.5 Aug††
Norway	+5.9 Q2	+2.4	+2.5	+2.2	−5.7 Aug	+5.3 Sep	−0.3	+3.3	2.4 Jul***
Poland	+5.8 Q2	na	+5.4	+4.3	−3.7 Aug	+4.5 Sep	+2.3	+4.2	9.3 Aug‡‡
Russia	+7.8 Q2	na	+7.5	+6.8	+6.3 Sep	+16.1 Sep	+9.4	+14.0	5.3 Aug‡‡
Sweden	+0.7 Q2	−0.1	+1.3	+1.0	−1.8 Aug	+4.4 Sep	+2.2	+3.8	5.9 Sep‡‡
Switzerland	+2.4 Q2	+1.5	+2.0	+1.1	+6.1 Q2	+2.9 Sep	+0.7	+2.6	2.6 Sep
Turkey	+1.9 Q2	na	+3.7	+3.2	−4.0 Aug	+12.6 Sep	+7.1	+10.2	9.0 Q3‡‡
Australia	+2.7 Q2	+1.1	+2.6	+2.3	+2.8 Q2	+4.5 Q2	+2.1	+4.2	4.3 Sep
Hong Kong	+4.2 Q2	−5.5	+4.7	+4.4	−4.2 Q2	+4.6 Aug	+1.6	+5.3	3.2 Aug††
India	+7.9 Q2	na	+7.3	+6.8	+1.3 Aug	+9.0 Aug	+7.3	+7.9	7.2 2007
Indonesia	+6.5 Q2	na	+5.8	+5.5	+2.9 Aug	+11.0 Sep	+7.0	+10.3	8.5 Feb
Malaysia	+6.3 Q2	na	+6.0	+5.6	+0.9 Aug	+8.5 Aug	+1.9	+5.4	3.5 Q2
Pakistan	+5.8 2008**	na	+6.0	+4.4	−3.9 Jul	+23.9 Sep	+8.4	+18.6	5.6 2007
Singapore	−0.5 Q3	−6.3	+4.0	+3.8	−12.2 Aug	+6.4 Aug	+2.9	+6.5	2.3 Q2
South Korea	+4.8 Q2	+3.4	+4.6	+3.3	+1.9 Aug	+5.1 Sep	+2.3	+4.9	3.1 Sep
Taiwan	+4.3 Q2	na	+4.3	+3.4	+0.4 Aug	+3.1 Sep	+3.1	+3.8	3.9 Aug
Thailand	+5.3 Q2	+2.9	+4.8	+3.9	+7.9 Aug	+6.0 Sep	+2.1	+6.4	1.2 Jun
Argentina	+7.5 Q2	+8.7	+6.0	+3.5	+4.2 Aug	+8.7 Sep	+8.6	+9.3	7.8 Q3‡‡
Brazil	+6.1 Q2	+6.6	+4.6	+3.4	+2.0 Aug	+6.3 Sep	+4.1	+6.0	7.6 Aug‡‡
Chile	+4.3 Q2	+7.4	+3.9	+3.3	−3.1 Aug	+9.2 Sep	+5.8	+8.7	8.2 Aug††‡‡
Colombia	+3.7 Q2	+2.8	+4.5	+4.0	+0.7 Jul	+7.6 Sep	+5.0	+6.7	11.1 Aug‡‡
Mexico	+2.8 Q2	+0.6	+2.3	+2.5	−0.3 Jul	+5.5 Sep	+3.8	+4.8	4.2 Aug‡‡
Venezuela	+7.1 Q2	na	+5.4	+2.7	−2.5 Jun	+36.0 Sep	+15.3	+31.0	7.5 Q2‡‡
Egypt	+6.8 Q2	na	+7.1	+6.7	+6.8 Q2	+21.5 Sep	+9.3	+17.1	9.0 Q1‡‡
Israel	+4.9 Q2	+4.2	+4.0	+3.2	+9.7 Jul	+5.5 Sep	+1.4	+4.3	5.9 Q2
Saudi Arabia	+3.5 2007	na	+7.2	+5.1	na	+10.9 Aug	+5.0	+8.5	na
South Africa	+4.5 Q2	+4.9	+3.4	+3.3	+0.4 Aug	+13.7 Aug	+6.7	+11.3	23.1 Jun‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−1.1 Q2	−3.2	−1.5	+0.4	−2.6 Aug	+10.5 Sep	+7.2	+10.5	4.0 Jul
Finland	+2.4 Q2	+3.1	+2.6	+1.1	−1.1 Aug	+4.7 Sep	+2.6	+4.0	6.4 Aug
Iceland	+5.0 Q2	+20.9	nil	+0.8	+0.4 2007	+14.0 Sep	+4.2	+12.0	1.3 Sep‡‡
Ireland	−0.8 Q2	−2.1	−0.5	−0.1	+4.2 Aug	+4.3 Sep	+4.6	+4.0	6.3 Sep
Latvia	+0.1 Q2	na	−0.4	+0.5	−11.1 Aug	+14.9 Sep	+11.4	+15.8	5.7 Jul
Lithuania	+5.2 Q2	+4.5	+5.1	+3.7	na	+11.1 Sep	+7.0	+10.8	4.7 Aug‡‡
Luxembourg	+2.8 Q2	+4.5	+2.8	+2.6	+11.9 Aug	+4.0 Sep	+2.1	+4.0	4.2 Aug‡‡
New Zealand	−0.3 Q2	−2.1	+0.4	+1.5	+2.4 Q1	+4.0 Q2	+2.0	+4.1	3.9 Q2
Peru	+8.9 Aug	na	+9.1	+6.5	+5.6 Aug	+6.2 Sep	+2.8	+5.7	8.6 Aug‡‡
Philippines	+4.6 Q2	+8.4	+4.7	+5.4	+8.1 Jul	+11.9 Sep	+2.7	+9.6	7.4 Q3‡‡
Portugal	+0.7 Q2	+1.4	+1.4	+1.3	−0.4 Aug	+3.1 Sep	+2.1	+2.7	7.3 Q2‡‡
Slovakia	+7.6 Q2	na	+7.0	+5.2	+0.9 Aug	+5.4 Sep	+2.9	+4.4	7.5 Sep‡‡
Slovenia	+5.5 Q2	na	+4.5	+3.5	−7.1 Aug	+5.5 Sep	+3.5	+6.0	6.5 Jul‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 5.0% in Sept. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Oct 16th 2008
From The Economist print edition

The Economist commodity-price index

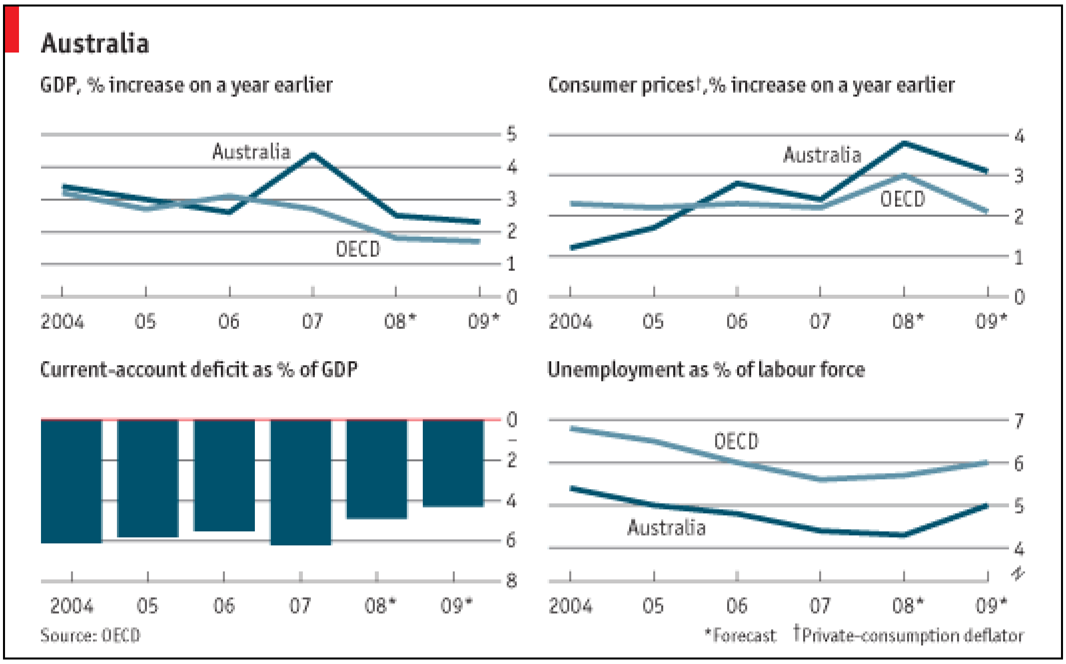
2000=100

	Oct 7th	Oct 14th*	% change on one month	% change on one year
Dollar index				
All items	190.4	183.0	−16.7	−15.1
Food	194.3	189.9	−15.1	−1.9
Industrials				
All	185.4	174.1	−18.9	−28.6
Nfa†	153.9	142.1	−19.9	−14.3
Metals	202.6	191.7	−18.4	−33.1
Sterling index				
All items	164.1	158.2	−15.7	−1.6
Euro index				
All items	129.1	124.2	−13.7	−11.8
Gold				
$ per oz	877.40	838.40	+7.8	+10.5
West Texas Intermediate				
$ per barrel	89.85	79.35	−14.9	−9.3

*Provisional †Non-food agriculturals.

Australia

Oct 16th 2008
From The Economist print edition



Trade, exchange rates, budget balances and interest rates

Oct 16th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Oct 15th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−848.0 Aug	−699.0 Q2	−4.7	–	–	−2.5	2.12	4.01
Japan	+77.9 Aug	+197.3 Aug	+3.9	101	117	−3.0	0.78	1.57
China	+258.0 Sep	+371.8 2007	+8.5	6.83	7.52	0.4	4.23	3.30
Britain	−188.9 Aug	−82.9 Q2	−3.1	0.57	0.49	−3.8	6.38	4.71
Canada	+50.8 Aug	+13.6 Q2	+1.1	1.18	0.97	0.2	1.63	3.87
Euro area	−10.8 Jul	−38.5 Jul	−0.4	0.74	0.70	−0.9	5.17	4.12
Austria	−0.1 Jul	+14.5 Q2	+2.6	0.74	0.70	−0.8	5.17	4.46
Belgium	+5.5 Jun	−9.8 Jun	+1.6	0.74	0.70	−0.6	5.24	4.58
France	−76.9 Aug	−54.2 Aug	−1.8	0.74	0.70	−2.9	5.17	4.32
Germany	+279.8 Aug	+269.3 Aug	+6.5	0.74	0.70	1.1	5.17	4.12
Greece	−67.2 Jun	−50.5 Jul	−14.0	0.74	0.70	−3.3	5.24	4.95
Italy	−15.4 Aug	−71.4 Jul	−2.5	0.74	0.70	−2.6	5.17	4.81
Netherlands	+60.1 Aug	+62.5 Q2	+6.2	0.74	0.70	0.7	5.17	4.37
Spain	−154.1 Jul	−165.2 Jul	−9.8	0.74	0.70	−1.6	5.17	4.58
Czech Republic	+6.4 Aug	−4.3 Aug	−2.8	18.2	19.4	−1.9	4.14	4.15
Denmark	+6.4 Aug	+5.9 Aug	+1.3	5.49	5.25	3.8	5.95	4.60
Hungary	+0.5 Aug	−8.8 Q2	−5.9	197	177	−4.0	8.88	8.31
Norway	+83.2 Sep	+78.1 Q2	+17.3	6.36	5.40	17.7	6.56	4.37
Poland	−22.2 Aug	−26.3 Aug	−4.9	2.59	2.61	−1.9	6.80	6.32
Russia	+200.3 Aug	+104.3 Q2	+6.2	26.2	24.9	4.5	11.00	8.47
Sweden	+18.7 Aug	+38.6 Q2	+7.6	7.31	6.45	2.4	3.28	3.73
Switzerland	+17.3 Aug	+60.2 Q2	+13.0	1.13	1.18	0.9	3.10	2.88
Turkey	−76.0 Aug	−48.7 Aug	−6.4	1.43	1.21	−1.8	19.47	9.86‡
Australia	−15.6 Aug	−61.1 Q2	−5.1	1.46	1.12	1.3	6.07	5.36
Hong Kong	−26.3 Aug	+27.5 Q2	+9.0	7.76	7.75	3.0	4.34	2.60
India	−100.3 Aug	−21.9 Q2	−2.9	48.5	39.5	−4.3	8.46	8.40
Indonesia	+19.0 Sep	+6.3 Q2	+2.8	9,780	9,095	−2.0	11.35	12.31‡
Malaysia	+41.0 Aug	+35.3 Q2	+14.4	3.51	3.38	−3.1	3.68	5.12‡
Pakistan	−22.5 Sep	−14.0 Q2	−8.6	80.7	60.6	−6.4	14.79	24.21‡
Singapore	+25.5 Aug	+32.8 Q2	+18.6	1.47	1.46	1.0	1.38	2.99
South Korea	−11.5 Sep	−7.1 Aug	−3.3	1,238	918	1.1	6.03	5.44
Taiwan	+6.9 Sep	+32.6 Q2	+4.6	32.4	32.6	−1.8	2.60	2.19
Thailand	+5.4 Aug	+7.8 Aug	+1.1	34.1	34.2	−2.9	3.85	4.18
Argentina	+13.2 Aug	+6.0 Q2	+3.1	3.20	3.16	0.7	16.50	na
Brazil	+28.8 Sep	−21.9 Aug	−1.6	2.19	1.81	−1.6	13.67	6.16‡
Chile	+16.1 Sep	+1.0 Q2	−0.5	632	501	6.5	9.84	3.84‡
Colombia	+1.8 Jul	−4.9 Q2	−2.6	2,330	1,986	−1.0	9.85	8.93‡
Mexico	−9.4 Aug	−5.3 Q2	−0.8	12.8	10.8	−0.1	7.80	8.94
Venezuela	+41.9 Q2	+37.8 Q2	+14.8	5.00	4.23§	1.6	17.05	6.55‡
Egypt	−23.4 Q2	+0.9 Q2	+0.2	5.58	5.55	−7.1	13.48	7.11‡
Israel	−13.1 Aug	+3.5 Q2	+0.2	3.67	4.03	−1.0	3.40	5.11
Saudi Arabia	+150.8 2007	+95.0 2007	+33.1	3.77	3.74	13.3	4.66	na
South Africa	−10.3 Aug	−22.5 Q2	−7.7	9.42	6.81	0.2	12.30	9.02
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.3 Jul	−3.3 Aug	−11.8	11.5	11.0	−0.5	6.62	na
Finland	+11.9 Aug	+10.6 Aug	+3.8	0.74	0.70	4.5	5.21	4.49
Iceland	−0.9 Sep	−4.5 Q2	−14.6	110	60.3	2.0	15.97	na
Ireland	+38.2 Jul	−15.8 Q2	−3.5	0.74	0.70	−3.9	5.17	4.72
Latvia	−6.9 Aug	−5.5 Aug	−13.8	0.52	0.50	−1.5	8.91	na
Lithuania	−8.0 Aug	−6.8 Aug	−14.0	2.54	2.43	−0.7	6.78	na
Luxembourg	−6.9 Jul	+5.1 Q2	na	0.74	0.70	0.5	5.17	na
New Zealand	−3.2 Aug	−11.4 Q2	−7.1	1.62	1.33	0.3	7.05	6.04
Peru	+6.3 Aug	−1.5 Q2	−1.6	3.09	3.02	2.7	6.50	na
Philippines	−8.7 Jul	+4.3 Jun	+2.8	47.6	44.2	−0.8	5.56	na
Portugal	−32.9 Jul	−27.8 Jun	−9.0	0.74	0.70	−2.5	5.17	4.60
Slovakia	−0.9 Aug	−5.6 Jun	−5.6	22.5	23.7	−2.1	1.94	4.77
Slovenia	−4.5 Aug	−3.1 Jul	−6.6	0.74	0.70	0.4	5.24	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

Oct 16th 2008
From The Economist print edition

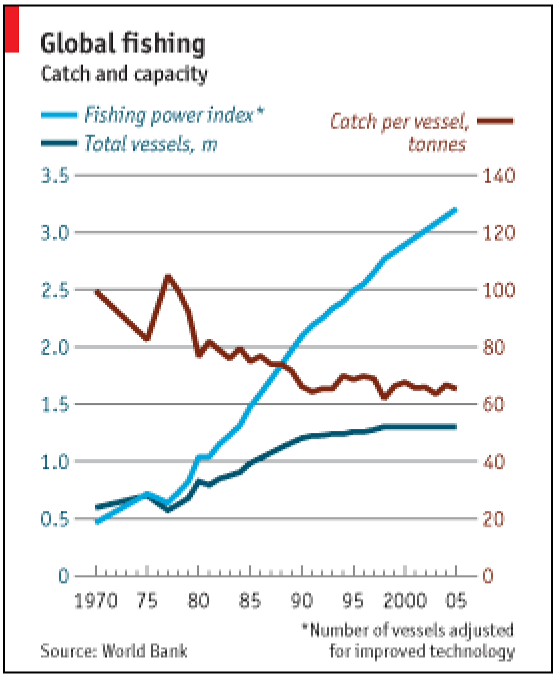
Markets

	Index	% change on	Dec 31st 2007	
	Oct 15th	one week	in local currency	in $ terms
United States (DJIA)	8,577.9	-7.3	-35.3	-35.3
United States (S&P 500)	907.8	-7.8	-38.2	-38.2
United States (NAScomp)	1,628.3	-6.4	-38.6	-38.6
Japan (Nikkei 225)	9,547.5	+3.7	-37.6	-31.2
Japan (Topix)	955.5	+6.3	-35.2	-28.6
China (SSEA)	2,095.0	-4.7	-62.1	-59.4
China (SSEB, $ terms)	111.2	-7.4	-71.6	-69.6
Britain (FTSE 100)	4,079.6	-6.6	-36.8	-44.6
Canada (S&P TSX)	9,323.9	-7.3	-32.6	-43.4
Euro area (FTSE Euro 100)	791.5	-3.8	-42.4	-46.5
Euro area (DJ STOXX 50)	2,578.1	-4.3	-41.4	-45.6
Austria (ATX)	2,270.2	+0.7	-49.7	-53.3
Belgium (Bel 20)	2,082.6	-10.4	-49.5	-53.1
France (CAC 40)	3,381.1	-3.3	-39.8	-44.1
Germany (DAX)*	4,861.6	-3.0	-39.7	-44.0
Greece (Athex Comp)	2,381.6	-5.2	-54.0	-57.3
Italy (S&P/MIB)	22,221.0	-0.2	-42.4	-46.5
Netherlands (AEX)	263.0	-7.9	-49.0	-52.6
Spain (Madrid SE)	1,043.8	-5.6	-36.4	-40.9
Czech Republic (PX)	998.8	-4.2	-45.0	-45.0
Denmark (OMXCB)	278.1	+3.1	-38.0	-42.4
Hungary (BUX)	14,484.1	-10.4	-44.8	-51.5
Norway (OSEAX)	293.9	-2.7	-48.4	-56.0
Poland (WIG)	30,997.3	-7.9	-44.3	-47.0
Russia (RTS, $ terms)	789.0	+3.6	-63.3	-65.6
Sweden (Aff.Gen)	200.0	-1.4	-41.2	-48.0
Switzerland (SMI)	5,911.2	-2.7	-30.3	-30.4
Turkey (ISE)	30,536.2	-0.8	-45.0	-54.8
Australia (All Ord.)	4,272.5	-2.2	-33.5	-50.3
Hong Kong (Hang Seng)	15,998.3	+3.7	-42.5	-42.2
India (BSE)	10,809.1	-4.6	-46.7	-56.7
Indonesia (JSX)	1,520.4	+4.7	-44.6	-46.8
Malaysia (KLSE)	949.9	-2.1	-34.3	-38.1
Pakistan (KSE)	9,184.2	+0.1	-34.8	-50.1
Singapore (STI)	2,059.4	+1.3	-40.6	-41.8
South Korea (KOSPI)	1,340.3	+4.2	-29.4	-46.6
Taiwan (TWI)	5,246.3	+0.8	-38.3	-38.3
Thailand (SET)	481.5	-2.2	-43.9	-44.6
Argentina (MERV)	1,185.7	-12.8	-44.9	-45.8
Brazil (BVSP)	36,833.0	-4.6	-42.3	-53.1
Chile (IGPA)	11,648.2	+6.2	-17.3	-34.8
Colombia (IGBC)	7,666.8	-8.8	-28.3	-37.9
Mexico (IPC)	21,135.4	+2.2	-28.4	-39.1
Venezuela (IBC)	36,361.5	-1.8	-4.1	-58.8
Egypt (Case 30)	5,972.6	+1.3	-43.0	-43.6
Israel (TA-100)	695.7	-2.9	-39.7	-36.7
Saudi Arabia (Tadawul)	6,863.2	+11.4	-37.8	-38.1
South Africa (JSE AS)	20,571.9	-1.8	-29.0	-48.5
Europe (FTSEurofirst 300)	903.7	-3.9	-40.0	-44.3
World, dev'd (MSCI)	950.4	-5.3	-40.2	-40.2
Emerging markets (MSCI)	623.3	+2.9	-50.0	-50.0
World, all (MSCI)	236.6	-4.6	-41.3	-41.3
World bonds (Citigroup)	740.8	-2.2	+1.4	+1.4
EMBI+ (JPMorgan)	361.6	-5.6	-16.6	-16.6
Hedge funds (HFRX)	1,107.5	-0.2	-16.7	-16.7
Volatility, US (VIX)	69.3	57.5	22.5	(levels)
CDSs, Eur (iTRAXX)†	132.6	+4.1	+162.0	+143.4
CDSs, N Am (CDX)†	208.1	+6.4	+167.2	+167.2
Carbon trading (EU ETS) €	22.9	+4.9	+3.1	-4.2

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

Global fishing

Oct 16th 2008
From The Economist print edition



Up to $50 billion a year is lost to poor management, inefficiency and overfishing in world fisheries, according to a new report published jointly by the World Bank and the UN Food and Agriculture Organisation. The report puts the total loss over the past three decades at $2.2 trillion. The industry's fishing capacity continues to increase year after year. The number of vessels is flat, but each boat has greater capacity thanks to improved technology. Because of overcapacity, much of the extra investment in new technology is wasted. The amount of fish caught at sea has barely changed in the past decade. Fish stocks are depleted, so the effort expended in catching each fish is higher than it need be.